

## THE EXECUTIVE

28 OCTOBER 2003

### JOINT REPORT OF THE DIRECTOR OF CORPORATE STRATEGY AND THE DIRECTOR OF FINANCE

<b>LOCAL AUTHORITY BUSINESS GROWTH INCENTIVES</b>	<b>FOR DECISION</b>	
<p><i>This report is presented to the Executive as it has potentially positive financial implications for the Council.</i></p> <p><b><u>Summary</u></b></p> <p>The government is consulting on a new scheme to create greater incentives for local authorities to promote economic development in their areas, by allowing local authorities to directly retain a proportion of business rate revenues. Revenues from the scheme will not be ring fenced and local authorities will be free to spend them on local priorities as they choose. The scheme will take effect from 1 April 2005, but local authorities are invited to take part in an administrative “dry run” in 2004. This report considers the potential benefits to Barking and Dagenham and recommends a response. The government’s deadline for the consultation is 31 October 2003.</p> <p><b><u>Recommendations</u></b></p> <p>The Executive is asked to:</p> <ol style="list-style-type: none"><li>1. Welcome the scheme and agree the report as the basis for our response, whilst promoting Barking and Dagenham’s more radical alternative;</li><li>2. Volunteer to take part in the administrative “dry run”; and</li><li>3. Consider at the proper time, as part of the budget setting process and in relation to other priorities, allocating a part of any new funds gained under the scheme to support more economic development work by the Council.</li></ol> <p><b><u>Reasons</u></b></p> <p>The scheme has the potential for significant financial gain to the Council.</p>		
<b>Contact Officers:</b> Jeremy Grint Alan Evens Tony Freeman	Head of Regeneration NNDR Service Manager Regeneration Finance	Tel: 020 8227 2443 Tel: 020 8227 2573 Tel: 020 8227 2855

#### **1. Background**

- 1.1 Current arrangements for local government financing do not fully recognise or reward the contribution that local authorities make to economic growth. Since 1990 business rate revenues have been paid into a central pool and then redistributed to local authorities on a per capita basis. This means that local authorities do not get

a direct local benefit, despite bearing the costs of collection and many of the costs of economic development. There is no direct financial incentive for them to do more to encourage economic growth in their areas. It also creates a sense of grievance among local businesses, which see no direct connection between rates collected and spending in the area.

- 1.2 HM Treasury (HMT) and the Office of the Deputy Prime Minister (ODPM) have therefore developed a scheme to create stronger incentives for local authorities to work with businesses and other partners to encourage growth in their areas. The scheme will allow local authorities to individually retain some of the business rate revenues that come from growing the business rate tax base at a local level.
- 1.3 No business will pay more non-domestic rates through the scheme. Revenues from the scheme will not be ring fenced and local authorities will be free to spend them on local priorities as they choose. The government has also said that there will be no reduction in spending totals set in the 2002 Spending Review as a result of the scheme. We should ask them to extend this commitment to the 2004 Spending Review.
- 1.4 A joint report from HMT and ODPM, *Local Authority Business Growth Incentives – A Consultation Paper*, sets out the scheme in detail and asks for views on a number of operational issues. These include the options for setting a baseline from which growth is measured, the level above which a local authority will retain revenues (the “floor”) and the proportion of revenues that the local authority will retain above the “floor”. The government has also asked local authorities to volunteer to take part in an administrative “dry run”. The deadline for the consultation is 31 October 2003.

## **2. Barking and Dagenham’s alternative**

- 2.1 We should welcome the principles behind the scheme, the opportunity to benefit from an additional funding stream and the government’s commitment not to ring-fence additional revenues. However, the government’s proposals have serious flaws. They are bureaucratic and may prove difficult to administer. They allow local authorities to retain only a part of additional business rate revenues. Most importantly, they would not create a predictable funding flow and this could in practice limit the purposes to which any additional funds could be put.
- 2.2 Barking and Dagenham collaborated with London First to develop a more radical proposal in January 2003, which we believe would be more successful in meeting the government’s objectives than their current proposals. Our Local Tax Reinvestment Programme is based on successful experience in the USA. It proposes a pilot project in Barking and Dagenham to allow the Council to keep all additional business rate revenues above a baseline which would remain constant from year to year. The money accrued would be used to fund future infrastructure improvements by allowing private investors to borrow against it. Our scheme would release larger amounts of capital and would create a much more predictable funding flow. In welcoming the government’s current proposals, we should also use this opportunity to try to revitalise government interest in our pilot project.

### **3. The impact of the government's proposals on Barking and Dagenham**

- 3.1 The borough economy has suffered some decline in the period since 1995, with a particularly marked loss of jobs at the turn of the century caused by Ford's decision to end manufacturing at its Dagenham plant. The long-term decline in national and London manufacturing is predicted to continue and the borough will not be immune from this trend.
- 3.2 However, the unfolding of the government's Sustainable Communities agenda and the regeneration of Thames Gateway will reverse this trend. The development of Dagenham Dock as a Sustainable Industrial Park for environmental industries and "green" technologies is already far advanced. It will make the borough into the premier location for environmental businesses and tap into a huge market that will continue to grow rapidly in response to national and EU legislation. The redevelopment of Barking Town Centre will create opportunities for business growth in leisure, retail and business services. The borough's draft Economic Development Strategy, which is also on the agenda for this meeting of the Executive, sets out a framework for action to make the most of these opportunities.
- 3.3 The government's scheme therefore affords the opportunity to benefit from the expected economic development in Barking and Dagenham and to use resulting revenues to address some of the borough's social needs. We expect the business rate tax base to rise quickly from a relatively low level, both because of an increase in the number of businesses and from growth in the underlying rental value of business properties. It is difficult to predict how much rates revenue may be retained locally at this stage as the Government has proposed several different calculation methods. However under all proposed methods the maximum amount retained by Barking and Dagenham would be £2 million in any one year.
- 3.4 It is important to recognise that the proposed scheme does not offer any guarantees. If an authority fails to meet the minimum growth levels set by the Government, it will not receive any additional funding. Additional funding is based on the previous year's performance and the following year's baseline will reflect the growth already achieved. This means that under the current proposals there would be no guaranteed income flow from the scheme and that significant financial benefits can only be expected from growth that exceeds the targets set by Government. For example, the Council could make the maximum £2 million from the scheme in one year, nothing the year after and then a small amount in the third. The opportunity provided by the scheme to retain revenue locally should therefore be welcomed, but treated with caution.

### **4. The government's consultation**

- 4.1 The key technical issue for the scheme is the baseline. This determines the trend growth relative to which individual local authority floors are set. The government proposes to use the period from 1995 to 2003 as the trend growth rate. It then asks local authorities to choose between five different ways of grouping local authorities for determining the baseline, two of which the government has identified as preferred options at this stage of the consultation. The total rateable value of the borough has not shown any consistent trend over the period since 1995 and it is therefore recommended that a baseline calculated on the past performance of the

borough would be more beneficial to the Council than baselines calculated on either regional or national trends.

- 4.2 The government has also asked local authorities to choose between two options for determining the level above which a local authority will retain revenues (the “floor”) and the proportion of revenues that the local authority will retain above the “floor” (the “scaling”). Officers are carrying out further research to identify which options would be most favourable to the Council, so that the Council can respond to this question.
- 4.3 The government has proposed using Formula Spending Shares (FSS) to determine a cut off point for revenues received from the scheme (the “ceiling”). This would not provide a good measure, since Formula Spending Shares are subject to year-on-year functional changes as grants move in and out of FSS and duties change between public sector bodies. In addition, a full review of FSS is planned for 2006/07, which would be the second year of the business growth incentive scheme. For these reasons and because Barking and Dagenham expects to see significant economic growth over the next few years, we should reject this in favour of keeping all additional revenues above the baseline. We can justify our position on the grounds that economic growth will itself place a further burden on Council resources (roads, rubbish collection etc) and the Council should therefore be entitled to retain the full amount to revenue to meet the additional demand on services, as well as to benefit local people.
- 4.4 Local authorities are also asked to indicate how revenues should be divided between tiers of local government – in our case between the borough and the GLA. Whilst recognising the contribution of the GLA and London Development Agency to the development of the wider Thames Gateway, our view is strongly that we should seek to retain as big a proportion of the revenue as possible. The Council’s local knowledge and closeness to the community mean that it is better placed to make an optimal allocation of the additional revenues to community priorities.

## **5. Administrative “dry run” and financial impact**

- 5.1 The growth incentive scheme will require some changes to local authorities’ existing administrative arrangements. It will also require local authorities to supply some information to central government so that it can monitor the additional revenue retained. The government intends to test these new arrangements throughout 2004 and has asked local authorities to volunteer to take part in the administrative “dry run”.
- 5.2 Taking part would make some extra demands on the Council’s administrative resources. It is not yet clear what level of additional resource would be required to support the pilot. The Council should lobby for financial assistance from the government if new systems necessitated significant, additional revenue or capital expenditure - for example if we had to commission new or amended IT systems, or recruit and train new staff. If it became clear in such a case that the government would not provide financial assistance and the likely costs of participation were considered to be excessive, we should reconsider our involvement in the scheme.

5.3 Nevertheless, taking part in the “dry run” will raise the profile of the borough, give the Council a direct voice in designing a system most suitable to Barking and Dagenham, and help the Council prepare for the introduction of the scheme proper. We therefore recommend that the Council offer to take part in the “dry run”, but makes the financial caveats set out above, clear in its response.

## **6. Using part of the revenue to fund economic development work**

6.1 The scheme allows the Council to spend any additional resources received on local priorities as it chooses. Without pre-empting the budget setting process, we would suggest that the Executive considers at the proper time allocating a proportion of any additional revenue to fund extra work by the Council to promote economic development and that we note this point in our response to the consultation. This would help create a virtuous circle within the borough, in which economic development would continue to create additional resources to meet social needs. Noting this intention in our response to the government would indicate our commitment to the new scheme’s overarching objective of promoting greater local authority involvement in economic development.

6.2 Whatever the purposes to which the Council allocates any additional funding received under this scheme, it should be noted that such funding would effectively be retrospective, since the growth achieved in a financial year would not be known until after the end of the year. This effectively means that the funds would not be immediately available, nor could any commitment be made with those funds that anticipated a sustainable revenue stream.

6.3 It is also likely to limit the incentive for local authorities to do more to promote economic development - the Government’s explicit purpose in designing the scheme. Should the Council increase spending on regeneration to encourage economic growth it will be spending additional funds with no guarantee of any return. This arrangement will naturally favour those authorities with the resources available for up front funding to promote economic development. We will note these points in our response to the government.

## **7. Consultation**

7.1 The report was developed by officers from Regeneration, Regeneration Finance and Revenue Services.

## **Background papers**

The government’s consultation paper, *Local Authority Business Growth Incentives* is available from the website of the Office of the Deputy Prime Minister, [www.odpm.gov.uk](http://www.odpm.gov.uk)