

Lyons inquiry into Local Government Funding

April 2005

Introduction

The British Chambers of Commerce welcome the opportunity to participate in this inquiry. Having consulted the BCC network, which represents some 100,000 businesses across the UK economy, the opinions of business are represented below. We trust that our opinions will be given due weight.

1 Summary

1.1 With regards to the current inquiry into the Balance of Local Government Funding, the British Chambers of Commerce's (BCC) key concern is the suggestion that the setting of the business rate should be returned to the control of local authorities. We are concerned that such a step would lead to increased business rates, which would serve to discourage, rather than foster, enterprise.

1.2 Prior to 1990, when business rates were last set at a local level, increases were often excessive and unrelated to the service provided to business. Because businesses do not vote, we fear that re-localisation would again lead to excessive business rate increases because authorities could do so without the political problems that arise with increases in domestic rates

1.3 The contribution of business rates towards local government finance is already substantial. In 2005-06, business rates contributed £18 billion to local government revenue. On top of this, local government is also partly financed by central government grants to which business contributes through numerous other taxes. The most costly of these is corporation tax, forecast to raise £43.7 billion in 2005-06.¹

1.4 Business is not opposed to paying a fair business rate, but we believe that there must be accountability and it should be related to the services that are provided. There is limited evidence that the relationship between businesses and local authorities has improved sufficiently to persuade us that local authorities should now be given back the control of business rates. In contrast, retaining the business rate at a national level ensures national scrutiny of it.

1.5 We are willing to seriously consider changes to local government funding where accountability is built in. As such, we support an element of local retention of rates, building on the Local Authority Business Growth Incentives Scheme (LABGI) and the existing powers for BIDs.

¹ Budget 2005

Chambers Key Concerns

2 Historical Lessons

2.1 Prior to 1989, individual local authorities were responsible for setting business rates in their geographical areas. However, there was considerable unease within the business community about this system because increases in costs under the local system had frequently proven to be arbitrary, excessive and unrelated to any benefit provided to business. By 1989, the proportion of local government spending that was funded by business rates had reached a high point of 29%.²

2.2 BCC and the Chamber network campaigned heavily at the time to have the setting of the business rate transferred to national level. Because many of the local authorities that had imposed the largest rises were located in Northern cities, Northern Chambers of Commerce were at the forefront of this campaign.

2.3 As a result of this pressure, the National Non-Domestic Rate (NNDR) was created by the Local Government Finance Act 1988, and introduced in 1990. Largely because it is inflation linked, the yield from non-domestic rates has been stable in real terms since 1990. This stability is of critical importance to businesses because it allows them to plan their future operations.

3 Threat of Increased Taxation

3.1 With regards to the current inquiry into the Balance of Local Government Funding, the British Chambers of Commerce's (BCC) key concern is the suggestion, argued most vociferously by the Local Government Association (LGA), that the setting of the business rate should be returned to the control of local authorities.

3.2 The BCC has significant concerns about this suggestion, which we fear would lead to an increase in business rates. Because business does not have a vote, the fear is that local authorities would be tempted to increase business rates, because they could enhance their spending power without enduring the political pain associated with increases in council tax.

3.3 The fear that re-localisation would lead to an increase in business rates is influenced by two key factors:

- The experience of what happened prior to 1989, when the business rate was last in the hands of local authorities and many authorities increased business rates to unsustainable levels.
- The language that is used by many of those in favour of re-localisation leads one to believe that the key motivation behind the wish to re-localise the business rate is to increase the revenue that comes from business in order to reduce the revenue that is generated from domestic ratepayers, through council tax. For example, the ODPM Select Committee have said:³ *“This change*

² ODPM Select Committee, *Local Government Revenue*, Ninth Report of 2003-04

³ ODPM Select Committee, *Local Government Revenue*, Ninth Report of 2003-04, p 60

would reduce the effects of gearing, take some of the pressure off the council tax payer and it would provide a real link between local authorities and business.”

3.4 The impact of increasing business rates in this way would be to discourage, rather than foster, enterprise. Increases would be particularly damaging to firms in disadvantaged areas, where the level of the increase deemed necessary by the local authority would almost certainly be higher than in more prosperous areas. This is worrying as the regeneration of disadvantaged areas is heavily reliant on a thriving and dynamic business community.

3.5 The key to enterprise in disadvantaged areas is through the stimulation, growth and retention of indigenous business. However, crime, a poor education and skills system, a heavy regulatory burden and high levels of taxation drive business away and lead to the problem deteriorating. In order to regenerate deprived areas, government at all levels must work to ensure that a climate conducive to trading is maintained. Small firms cannot grow into larger ones if they are strangled with red tape and taxation.

3.6 Further to this, a low tax economy allows businesses to develop and promotes enterprise and economic growth. This in turn allows businesses to create jobs and wealth, which will further the ability of employees to pay council tax.

4 Scotland and Ireland

4.1 The likelihood that devolved control of the business rate will lead to increases in the business rate is borne out by evidence from both Ireland and Scotland.

4.2 In Scotland the Scottish Executive has responsibility for setting the poundage rate, and in 2000 decided to end parity with England and establish a higher rate north of the border. The effect of this has been that Scottish businesses have seen a dramatic increase in their tax take over the intervening period, which has had an adverse impact on the competitiveness of businesses based in Scotland. The multiplier of 46.1% for 2005/6 is significantly higher than the rate of 42.2% for the same period in England. Restoring parity would reduce by £150 million the annual amount Scots based firms pay in non-domestic rates, which in 2005/06 will exceed £2 billion for the first time. The Scottish Chambers of Commerce is campaigning for a return to UBR parity with England.

4.3 Evidence from the Irish Republic suggests that local authorities will raise rates by more than inflation if they are given the opportunity. In Ireland, over the past decade (1994-2004), the average cumulative increase in commercial rates set by local authorities has been almost double the cumulative rate of inflation (CPI) over the same period. In 2003, rates increases were as high as 25%.⁴

4.4 The total take in commercial rates has increased from €538,090,400 in 1999 to €906,185,975 in 2004 which represents an increase of 68.41%. In some authorities

⁴ Chambers of Commerce of Ireland, ‘Local Authority Financing – Government in Denial’, 2004

over half of total expenditure is funded through commercial rates.⁵ The situation was further exacerbated in 2003 by the decision to abolish the cap on commercial rates increases, which had been set annually.

4.5 In addition to the increases in rates, Irish businesses also pay for: water; disposal of waste water; disposal of commercial waste; charges linked to planning permission/ development levies and the provision of parking.

5 Business already makes a large contribution.

5.1 The contribution of business rates towards local government finance is already substantial. In 2004-05, the funding of revenue expenditure from business rates was £15 billion. In 2005-06, the local government settlement states that the contribution will rise to £18 billion.⁶

5.2 On top of the £18 billion that business is expected to pay to local government through business rates in 2005-06, local government is also partly financed by central government grants. Business contributes to these grants through numerous other taxes, the most costly of which are corporation tax and employers' national insurance contributions.

5.3 In 2003/04 corporation tax raised £28.6bn⁷ and employers' national insurance contributions raised £41bn⁸. Other taxes on business include the climate change levy (£0.8bn), landfill tax (£0.6bn), VAT, stamp duty, capital gains tax, fuel tax and insurance premium tax.

5.4 The burden of these taxes is forecast to increase in the future. Indeed corporation tax is forecast to raise £43.7 billion in 2005-06.⁹

5.5 Overall, the business community in the UK actually has a fairly high burden of business taxation relative to many of our European competitors, in particularly many of the accession countries in the Eastern bloc. Indeed, in 2003 twelve countries in the EU have lower corporation taxes than we do. In the face of such competition, it would be damaging to our overseas competitiveness to raise business taxation further.

5.6 Whilst we are concerned about the possibility of general increases in business rates, it must be stressed that business is not opposed to paying a fair business rate. However, the key factors that should determine any changes should be accountability and a direct relationship to the services that are provided.

6 The national system provides accountability

6.1 Local businesses interact with local authorities in many ways. Businesses are important to local councils because they are the source of local economic activity; employ local people; provide council services in partnership with local authorities;

⁵ Chambers of Commerce of Ireland, *'Local Authority Financing – Government in Denial'*, 2004

⁶ Commons Hansard, 2 Dec 2004, Column 805

⁷ Budget 2005

⁸ ONS Annual Abstract 2005

⁹ Budget 2005

use local authority services; and are partners in development and regeneration. In addition to this, local councils are important to business because they: provide the necessary infrastructure; purchase goods and services; and regulate and enforce legislation affecting planning, building, trading and environmental objectives.

6.2 In order for this relationship to be productive and constructive, it is important that there is accountability. Prior to 1990, and the decision to set the business rate at a national level, one of the key complaints levelled at the system of local government was the poor relationship of many local authorities with business. Under these circumstances, there is taxation without representation. Businesses are taxed but unlike domestic consumers, they have no voting rights.

6.3 Unfortunately, whilst there are examples of individual councils working well with their local business communities, there is also evidence from other areas that local authorities are not doing enough to establish constructive relationships to benefit the local area. Some examples of Chamber / Local Authority relationships have been given by a number of Chambers of Commerce.

6.4 **Dudley** - An example of an area where relations have been positive in recent years is given by Dudley in the West Midlands. The Black Country Chamber of Commerce have highlighted four positive steps:

6.5 Dudley Business Group. - The Chamber and Dudley Metropolitan Borough Council (MBC) have held bi-monthly meetings for a number of years, which are used to express views comments from both sides. Membership includes local council leaders, chief officers, chamber president and board members. The Chamber have found these meetings particularly useful in resolving issues such as bus lanes, security on industrial estates, street cleaning etc.

6.6 Business Park Coordinators - The Chamber is sub contracted to Dudley and Sandwell MBC to deliver benefits to targeted business estates/parks in the two boroughs through the employment of business park coordinators. The funding for the posts is via the Council from Advantage West Midlands and is constantly monitored and measured for outputs and inputs.

6.7 Mayoral Visits - Through Chamber encouragement, over the last year the Mayor of Dudley has carried out a series of visits to local authorities and has held three business lunches - all in recognition of what business does for the community.

6.8 Business Development Manager - In order to create a better understanding and working relationship between private and public sector, Dudley MBC appointed last year a Business Development Manager whose main role is to liaise with business and provide assistance where possible

6.9 **North and Western Lancashire** - A number of good working links have also been highlighted in North and Western Lancashire. The North and Western Lancashire Chamber of Commerce have been offered a "hot desk" facility in a new Technology Centre free of charge by one local authority. The Chamber are also working closely with the County Council's Brussels office. It is pointed out, however, that the strength of the working links between the Chamber and LAs tend to

depend on the individual relationships members of staff have with LA officers. Good working relationships at an officer level tend to mean good links at a Member level.

6.10 **Tamworth** - A less satisfactory relationship with business has been identified in Tamworth. The local chamber of commerce, a division of the Southern Staffordshire chamber, identified that the local authority had taken the option not to devise an economic strategy. The chamber, together with the local FE college and other interested groups including Business Link, Job Centre Plus and secondary schools, formed an economic partnership. Among the primary targets for the group was the reduction of out-commuting, enhancing the infrastructure and environment so as to attract businesses with better paid jobs, making the curricula in schools and the college relevant to the skills needs of local employers and exploiting Tamworth's historic and locational advantages.

6.11 However, the partnership has failed because of a lack of input from the local authority, who insisted on imposing a level of bureaucracy that stifled progress. The Chamber have reported that officers *“belittled the proposals without offering constructive alternatives, agreed actions were often not carried out, reports were dilatory and incomplete and it became apparent that the authority had little or no respect for the work that was being done – mostly on a voluntary basis”*.

6.12 As a result the chamber has been forced to withdraw from the proposal and the partnership has failed. Tamworth, an area in need of economic assistance, now has no strategy to create or upgrade jobs, attract new investment or provide the stimulus that would encourage improved educational and vocational achievement. The chamber looks on this as a big opportunity sadly missed through *“incompetence and indifference”*.

6.13 Because of this imbalance in the strength of local partnership, we do not believe that there is sufficient evidence nationwide to suggest that all local authorities should now be given back the control of business rates. With insufficient accountability to business, there is a strong likelihood that we will see a return to previous times when business rates in many areas were increased to unsustainable levels, damaging business precisely because of the lack of a business vote.

6.14 In contrast, retaining the business rate at a national level ensures national scrutiny of it. Returning it to local control would avoid any effective accountability and we oppose it strongly.

6.15 Local authorities need to work with their business communities and see them as a means of driving forward economic development and prosperity. Currently Local Strategic Partnerships vary from one area to the next in terms of their effectiveness and the level of involvement with the business community in terms of influencing strategy.

6.16 Local authorities also need to engage more effectively with their business communities. The feeling in some areas is that consultation, whether it be through local groups such as LSPs or other means, is not always meaningful. This needs to change if local authorities are to work more effectively with their business communities.

7 Taxation should be set according to services provided

7.1 Local Authorities provide a range of services, many of which benefit business. Services that are of particular benefit to business include: approving planning applications; enforcing health, safety and trading standards requirements; issuing parking permits; waste disposal; street cleaning; and issuing premises licences to businesses who supply alcohol, provide entertainment or late night refreshments. Many local authorities also offer a range of business-support services to encourage economic development and regeneration.¹⁰

7.2 Although it is a difficult calculation to make, because of a lack of clarity about what exactly constitutes 'benefit to business', a past estimate has suggested that the proportion of local spending that benefits business is approximately 15%.¹¹ In contrast the proportion of local government spending that is funded by business rates has been greater than 20% in every year since 1989.

7.3 Evidence from other countries has suggested that creating a system whereby the non-residential sector is used to subsidise the residential sector can be economically harmful. A study conducted by academics from Trent University in Canada has examined data from all OECD countries and found that in countries with a fully developed property tax system, higher taxes are almost always imposed on non-residential properties when compared with residential properties. The consequence is that non-residential properties are used to subsidise services consumed by the residential sector. They conclude that the knock on effect of this can be to create serious economic problems for the country concerned:¹²

"If the local tax on business is set to recover the cost of services used, it is efficient, fair and accountable. The practice in many countries, however, is for local taxation to overtax business, thus creating potentially serious economic problems for the entire state or country. To prevent harmful and serious consequences, there may be a case for some state regulation."

7.4 To demonstrate their point they highlight other studies from Canada and the US.¹³

7.5 Canada - Two Canadian studies¹⁴ in the early nineties found that the residential sector when compared with the nonresidential sector was the recipient of

¹⁰ Business Link online

¹¹ Jackman (1987), 'Paying for local government: an appraisal of the British Government's proposals for non-domestic rates', Government and Policy, vol. 5, pp. 89-98

¹² Kitchen (2003) 'The Consortium for Economic Policy Research and Advice, Association of Universities and Colleges of Canada' Prepared for The Consortium for Economic Policy Research and Advice, Association of Universities and Colleges of Canada.

¹³ Kitchen (2003) 'The Consortium for Economic Policy Research and Advice, Association of Universities and Colleges of Canada' Prepared for The Consortium for Economic Policy Research and Advice, Association of Universities and Colleges of Canada.

¹⁴ Harry M. Kitchen and Enid Slack (1993), *Business Property Taxation*, Government and Competitiveness Project Discussion Paper no. 9324 (Kingston, Ont.: Queen's University, School of Policy Studies, 1993); and KPMG, "Study of Consumption of Tax Supported City Services", a report for the City of Vancouver, mimeograph, 1995.

proportionately more benefits from local government. When combined with higher effective property tax rates paid by the nonresidential sector, the studies concluded that the latter is overtaxed and the residential sector undertaxed. The studies point out that, based on this information, beginning in 1995, the local council in the City of Vancouver shifted, over the ensuing five years, some of its tax burden from the commercial and industrial sector onto the residential sector. More recently, the provincial government in Ontario announced that tax increases beyond the range of fairness (established as a standard that is defined by taking the ratio of commercial/industrial taxes to single dwelling residential property taxes) must be imposed on the residential sector and not on the commercial/industrial sector.

7.6 United States - A more recent study in the United States found similar results. Specifically, it was estimated that the ‘business related’ share of combined state and local expenditures in the United States is about 13 percent, although there is considerable variation from state to state. These businesses, however, pay proportionately more of the state and local taxes.¹⁵ The study found that because these taxes represent a fixed charge that the firm must pay, they are unrelated to the value of municipal services consumed or profits earned. As such, as long as the tax rate is more than necessary to cover the cost of the last unit of municipal services consumed or if there are no economic rents for it to capture, resources will be allocated inefficiently. It is suggested that this overtaxation of the nonresidential sector may lead to less economic activity, lower output, fewer jobs and a less competitive business environment.¹⁶

7.7 It has been suggested, by a number of bodies including the LGA and the ODPM Select Committee, that business rates are returned to local control but that increases be linked to the annual percentage increase in the domestic property tax in that area.^{17 18}

7.8 The BCC does not believe that this argument provides a legitimate basis for the setting of the business rate. It is our view that business rates should be related to the services that are provided for business.

8 Schemes such as Business Improvement Districts (BIDs) and the Local Authority Business Growth Incentives (LABGI) scheme are positive ways of engaging business.

8.1 Because the BCC believe that changes to the system of local government finance should be dependent on accountability and a relationship to the services that are provided, we are willing to seriously consider changes to local government funding where the necessary accountability is built in. As such, we do support an element of local retention of rates, building on the existing powers for BIDs and the Local Authority Business Growth Incentives Scheme (LABGI).

¹⁵ William H Oakland and William A Testa, ‘Community Development – Fiscal Interactions: Theory and Evidence from the Chicago Area’, Working Paper Series No 16 (Chicago, IL: Research Department: Federal Reserve Bank of Chicago.

¹⁶ *Report of the Technical Committee on Business Taxation (April 1998)*, (Ottawa: Department of Finance) at Chapter 2

¹⁷ ODPM Select Committee, ‘Local Government Revenue’, Ninth Report of 2003-04

¹⁸ LGA briefing paper, ‘the balance of funding a combination option: proposals for reforming local authority revenue’,

8.2 The BCC suggested Business Improvement Districts (BIDs) as an alternative to the Government's supplementary business rate proposals and we were pleased when this alternative was selected instead for implementation. Although every BID proposal should be judged on its individual merits, a good BID scheme should have the potential to ensure that local authorities engage more effectively with their business communities to improve their areas due to the voting rights of firms. The concept originated in the USA in the 1970s, where numerous BIDs have been successful in revitalising local areas. It is estimated that there are over 1000 BIDs operating in the North America today, with budgets ranging from \$3,000 to \$15m (US).¹⁹ One of the best known BIDs is Times Square in New York.

8.3 The BCC also believes that the Local Authority Business Growth Incentives (LABGI) scheme has the potential to benefit local business communities by focusing efforts on regeneration and policies to encourage business growth. The BCC is fully committed to the regeneration of deprived areas. We would like to see all areas fulfilling their economic potential and we are doing all we can through our Chamber network to achieve this aim. Based on this, it is our view that if this scheme has the desired effect of encouraging local authorities to adopt new business friendly policies in order to achieve economic growth then it will have achieved a welcome aim.

8.4 The BCC does still have some concerns about the LABGI scheme. In particular, we would suggest that, if there are to be rewards given for strong local authority performance, there is a case for some form of sanction for those local authorities that do not take the matter seriously enough. Local authorities must be forced to keep businesses at the forefront of their policy-making decisions to ensure that this does not simply become an automatic reward scheme

9 Alternative Options for Local Taxation

9.1 When looking at possible reform of the local government funding system, it may be judged that other forms of taxation are needed in the future to comprise a 'basket' of taxes and charges.

9.2 Possible suggestions might include the following:

- localised vehicle excise;
- local sales taxes;
- localised stamp duty;
- land value taxes;
- tourist taxes;
- more charging for services;
- congestions Charging;
- tourist Bed Taxes; and
- parking charges.

9.3 The BCC does not have a formal view on the creation of a 'basket' of new charges. We would caution, however, that for the most part, local authority services

¹⁹ British Retail Consortium online

should really be met from current budgets. Any proposals to add new charges or taxes would need to be fully costed and justified. These proposals would then need to be judged on their individual merits.

9.4 When charges of this nature have been proposed in the past, the BCC and the Chamber network have made individual judgments. A good example of this would be the issue of congestion charging. To date there have been three proposed congestion charging schemes in the UK; in London, Durham and Edinburgh. In these instances the BCC has not taken a central policy position but has stood by the position of the individual chambers of commerce in question.