

**CBI SUBMISSION TO LYONS' INQUIRY INTO
LOCAL GOVERNMENT FUNDING**

1. The CBI welcomes the chance to contribute to Sir Michael Lyons' inquiry. Business has a significant interest in this exercise as a contributor to local government funding (through national taxes, business rates and various local charges/fees) and as user of local services.
2. Our particular interest is in the focus on potential reform of the current arrangements for non-domestic rates in England (otherwise known as business rates). The CBI's detailed views on this issue were set out in our submissions to the 2004 Balance of Funding review (BoFR) and the separate ODPM Select Committee inquiry on Local Government Revenue (both of which are attached).
3. Many of the CBI's serious concerns about potential reform of business rates were reflected to differing degrees in the final BoFR and Select Committee reports. Between them, the two reports suggested broadly three options for change:
 - a) re-localisation of business rates with safeguards for business eg linking maximum increases to council tax increases. The Select Committee showed a clear preference for relocalisation as soon as possible and recommended in such circumstances the limiting of annual increase in business rates to no more than the annual percentage increase in council tax in the area
 - b) retention of the national system, but lifting the current inflation cap on rates increases. The removal of the cap was supported by the Select Committee (whether rates were set locally or nationally), with a view that the share of total local government revenue should rise to a "fairer" level of 25% (from 20% in 2004/05). For as long as business rates are set nationally, the Select Committee recommended that the Government should consider enshrining in primary legislation the maximum rate of increase above inflation that could be imposed; and announcing any above-inflation increases as part of a three year rolling programme
 - c) retention of the national system, but with some local retention of rates, building on the Local Authority Business Growth Incentives scheme (LABGI) and the existing powers for Business Improvement Districts (BIDs): this was the third option identified by the BoFR, but was not recommended by the Select Committee.
4. All three options clearly seek to increase the contribution from business. This is a prospect that currently has little appeal for many businesses:
 - a) as a result of Budget policy measures since 1997 (ie not including things like the inflation-related increase in business rate revenue), UK business and its investors will have paid almost £60 billion more in tax than would otherwise have been the case, in the ten-year period to spring 2007



- b) recent CBI analysis submitted to the Treasury ahead of the 2005 Budget indicates that the overall share of profits in GDP is lower at this stage of the current economic cycle compared with the level achieved in the 1970s, 1980s and 1990s cycles – with negative knock-on effects for business investment and the attraction of pension funds
 - c) ODPM research published last summer indicated that just over 40% of business properties would see their rates bills rise as a result of the 2005 revaluation (with the largest increases in rateable values affecting retailers and properties in the South and South East)
 - d) in addition, larger firms are due to pay for the new rates relief scheme for SMEs, while there is already the prospect of further mechanisms to increase contributions from business, such as a supplement on business rates in London to help fund CrossRail (possibly raising £2-3 billion) and a Planning Gain Supplement (recommended in the Barker report and on which consultation is likely later in 2005).
5. We therefore oppose any increase in business tax at this time, and in particular in those taxes on business which bear no relation to profitability, of which rates are one example (alongside others, such as employers' national insurance contributions). It is also worth bearing in mind that for the property industry generally this is a time of considerable activity in public policy (viz the debate about commercial leases) and the prospect of having to adapt to further change would not be seen as helpful.
6. Furthermore, the proposal generally to increase business rates (whether controlled nationally or locally) is neither logical nor robust before other issues have been satisfactorily addressed, such as the future role and shape of local government, or the scope for councils to deploy their current resources more efficiently. It is also unclear to what extent the local government community is actively pursuing other means of funding projects (for example, through Local Transport Plan bids or EU grants).
7. With regard to the first two options arising from last year's inquiries, as highlighted above, there are additional specific causes for concern:
- a) there is no substantive evidence to support the view that increasing business rate revenue to 25% of all local government revenue would be "fairer" than any other figure. Although the Select Committee failed to identify all the contributions made by business to local authority funding (eg some £2 billion annually in developer contributions), it rightly recognised that local government is also financed by central Government through national taxes paid by business (eg corporation tax). As indicated above, business has seen the burden of such taxes grow since 1997. Yet while individual taxpayers also pay national taxes, other than in their capacity as investors in business, they will on balance have gained approximately £35 billion (helped by the extension of tax credits and benefits) in the 10 years to 2007. This is less than the approximate £45 billion of above-inflation increases in council tax in that period, but still leaves business in a significantly worse net position by comparison
 - b) the suggestion that business rate revenues should rise to account for 25% of local government funding would mean raising an additional £3.75 billion annually from business in England compared with 2004/05. To put the degree of likely business hostility to such a move into perspective, this compares with the near £4 billion annual cost to all employers of the increase in national insurance contributions which came into effect in April 2003 - a move which seriously undermined business confidence in Government. The impact of having to pay for this increase varied by business, with CBI members reporting a diversion of resources which was otherwise intended for

items such as salary awards and pension schemes, or re-investment to strengthen their competitiveness (eg through R&D and capital expenditure)

- c) the use of safeguards for business in the event that the inflation cap was removed does offer a way of mitigating future increases under a reformed business rate system. However, in the case of linking increases in a locally-set business rate to council tax increases, this provides little comfort. Council tax rises between 1998/99-2002/03 had tended to range between 6%-8%, and in England in 2003/04 amounted to 12.9% - all significantly above inflation and contrary to the experience of many businesses who are under pressure to peg or even *reduce* prices in B2B or B2C markets.
8. Our submissions last year set out the CBI's clear preference for retaining the current approach to setting business rates, which offers firms several advantages, not least an important degree of stability and clarity in their financial planning. We do not believe the first two options for business rate reform described earlier in this note satisfactorily address the concerns we have expressed before and which remain topical. We strongly urge the Lyons Inquiry not to consider these options and instead propose that the Inquiry
- a) engage actively in the bigger questions of what levels of funding might be appropriate for local government more effectively to carry out its responsibilities in the future, and whether it has the right organisational culture and skills to match those responsibilities. This work should be integrated with other relevant initiatives, such as the "local:vision" work promoted by ODPM which is due later this year to publish a series of scenarios
 - b) encourage relevant bodies (as part of the above proposal) to consider in detail how far local government can improve efficiency. The Gershon review and subsequent government statements have identified around £6.5bn of savings expected from local authorities over the next three years. The delivery of these savings would significantly reduce the pressure for tax increases and increase business confidence that councils are delivering value for money. Local government's record in this area is disappointing – figures from the ODPM Autumn Performance Report 2004 show that council cost-effectiveness improved by just 0.1% between 2000/01 and 2002/3
 - c) promote the third of the options for reform as described earlier in this note – ie LABGI (which the Treasury estimates could yield £1billion over 3 years for local authorities in England and Wales) and BIDs (figures available for some of the 15 most advanced BIDs within the pilot programme comprising 23 projects suggest that these will generate annually at least £8 million of extra resources for local areas).
9. Finally, we note that the scope of the Lyons Inquiry (as with last year's BoFR) includes consideration of a possible local income tax (LIT) and other local taxes. Apart from the need to consider carefully the impacts (such as the creation of winners and losers) of such proposals, we would be very concerned if payroll administration costs and complexities associated with LIT (or the administrative costs of other taxes, such as those which might affect retailers in the case of a sales tax) were increased as a result. Any changes should not place additional burdens on business, should take account of the need to avoid discouraging work and should avoid penalising past or future saving.

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