

CIPFA'S COMMENTS ON THE PROPOSAL TO RETURN NON- DOMESTIC RATE SETTING AND RETENTION TO LOCAL AUTHORITY CONTROL

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Contact: Angela Scott
Head of CIPFA in Scotland
CIPFA in Scotland
Fettes Park
Second Floor
West Wing
496 Ferry Road
Edinburgh
EH5 2DL
angela.scott@cipfa.org

1. GENERAL COMMENTS

1.1. The general principle of the Member's proposal is one which CIPFA has supported for a number of years. At the outset, the position of CIPFA can be clearly stated, which is that:

- Non-Domestic Rates should be returned to the formal control of local authorities. The aim of this should be to work towards a balance of funding, of which more than one half is within local authority control.

1.2 CIPFA's views on NDRI and other elements of the local government finance system are summarised at Appendix 1. These represent extracted comments from CIPFA's submission to the independent Local Government Taxation Review Committee in March 2005.

1.3 The author is seeking comments to help him finalise the proposal to re-localise non-domestic rates. This consultation will undoubtedly result in a number of responses, which may show the historic positions of stakeholders developed over many years. In agreeing at the outset with the proposal, CIPFA believes that the time is right to consider more wide-ranging questions, and to seek a modernised solution to this ongoing issue.

Partnership with business

1.4 The return of NDRI to local government has long been seen as a way of re-establishing its links with the business community. Recent public sector reforms, however, have introduced a number of new ways for delivering public services, which have themselves now become established, for example:

- PFI;
- BIDS; and
- the use of independent residential care homes.

1.5 The common characteristic is that all of these methods of public service delivery rely on a partnership between the public and private sector.

1.6 In our detailed comments, we cover some of the comments made by business to the Lyons Inquiry, which indicate that some businesses are willing, under certain circumstances, to pay more proportional tax. Evidence exists which demonstrates that the domestic taxpayer has made a larger contribution to the cost of local government services over time. This is expressed in section 3 of this submission. It would be unfortunate if the intention of this proposal were simply to transfer this contribution to the business community, without any discussion about the benefits which arise from closer working with the business community.

1.7 Financial planning at a macroeconomic level, including funding mechanisms, is there to support and ensure the achievement of all strategic Scottish public service goals. Any review of local government taxation which fails to take account of these wider issues may serve the status quo, but not the progressive direction of Scottish public services. The opportunity exists, with the return of NDRI, to consider more fundamentally the role of business not only in terms of meeting the public sector's goals, but also in working to achieve wider economic objectives. Similarly, there is an opportunity to consider the investment which should be made by local government to support business – by whom and on what. This is particularly relevant to the community planning role of local government.

Accountability

1.8 The proposal is “designed to return to democratically elected local authorities the power to set and retain NDR in pursuit of greater local authority accountability and financial autonomy”.

1.9 The partnership models described above have existed within a method of accountability which favours the individual (the council tax payer). That same level of accountability is not afforded to business partners (the non-domestic ratepayer). One of the consequences of this unequal relationship is that tension between public and private sectors has long been a feature of the non-domestic rate. If today it is now recognised that public services can be delivered by a range of business partners, then these tensions should as a minimum be “designed out” of any reformed system and replaced by an approach to accountability which reflects that service delivery partnership.

1.10 Consequently, any finalised proposal will need to set out in more detail how it will lead to greater accountability and financial autonomy. In CIPFA's detailed comments, the inadequacy of the current accountability arrangements for NDRI is set out. Fundamentally, the draft proposal does not yet discuss reforms which will ensure that accountability is improved by the return of the rate.

1.11 Notably, irrespective of whether the proposed member's bill is successful, in CIPFA's opinion there is a need for this “accountability deficit” to be addressed.

1.12 In the following section, we have set out our initial thoughts on the specific questions which consultees are invited to comment upon. In some instances CIPFA poses some additional questions within its comments. CIPFA believes that seeking the answers to these questions, or at least being able to demonstrate that answers have been sought, will make the final proposal more robust.

2. DETAILED COMMENTS

What would the democratic benefits of this proposal be?

2.1 The proposal is designed to return to democratically elected local authorities the power to set and retain NDR in pursuit of greater local authority accountability and financial autonomy.

2.2 The Good Governance Standard for Public services ¹ presents 6 principles of good governance that are common to all public service organisations. Principle 6 states that good governance means engaging stakeholders and making accountability real. Real accountability is concerned not only with reporting on or discussing actions already completed, but also engaging with stakeholders to understand and respond to their views, as the organisation plans and carries out its activities.

2.3 When this standard is applied to the non-domestic rate system, it is clear that there is much to do in terms of both engagement and accountability.

2.4 The NDR can be compared to council tax in that both are compulsory levies which result in the provision of funding for local authority services. The following table indicates the differences:

	Council Tax	NDR
Democracy	The ability to vote for elected representatives	No vote afforded to business
Engagement	General consultation during budget process which results in the level of council tax being set	NDR set by Scottish ministers without consultation or opportunity to influence
Accountability	Legislative requirement to issue a council tax 'leaflet' to accompany each bill	No legislative requirement for a 'leaflet'

2.5 The Scottish Assessors are responsible for valuing the non domestic property in Scotland to determine rateable values. Scottish Ministers set the uniform poundage rate to be levied throughout Scotland for each year. The 32 local authorities are responsible for the day to day administration of the rating system in Scotland.

2.6 The Minister for Finance and Public Service Reform annually makes a Statement to the Scottish Parliament announcing the poundage rate in Scotland. These reports

¹ Good Governance Standard for Public Services published by the Independent Commission on Good Governance in Public Services which was established and supported by the Office for Public Management and CIPFA

actions which have already been completed, rather than representing engagement with stakeholders, in this case business and local government.

2.7 Consequently, CIPFA considers that there is an accountability deficit. Regardless of whether non-domestic rates are returned to local authority control or not, there is a need to address this deficit. CIPFA would recommend that consideration be given in the member's final proposal to how local government and the business community can genuinely engage with one another, in order that both parties have an understanding of the views and needs of each other.

2.8 Scottish Ministers, democratically elected, currently set the NDR. Council members are also elected democratically. The crucial difference for NDR payers compared to individuals is that use of the ballot box is not open to NDR payers as a collective body. Merely transferring the NDR from nationally elected politicians to locally elected politicians would not in itself resolve the democratic deficit. Consequently, further solutions need to be considered. In the absence of direct democratic business representation, business improvement districts may be a model which assists in resolving the accountability deficit.

Business Improvement Districts

2.9 Business Improvement Districts (BIDs), which exist here in the UK as well as overseas, are a model worth reviewing in this context. A BID is a public/private sector partnership in which property and business owners of a defined area elect to make a collective contribution to the maintenance, development and marketing and promotion of their commercial district. BIDs therefore present a model which allows local authorities to engage directly with local businesses outside the current NDRI system. Crucially, BIDs also give business a measure of influence over the level of 'tax' that is paid.

2.10 In 2004, the Chief Executive of Urban Place Consulting Group in Los Angeles summarised the core reasons as to why BIDs work as being:

- The provision of strong leadership;
- Ability to provide Consistent funding;
- Consistency of private sector management;
- A Focus on district (i.e. local) issues; and
- Strong public sector/private sector partnership

2.11 BIDs were largely unheard of until their emergence in Canada in the early 1970s, but now provide solutions at a local level with a measure of accountability built in.

2.12 Importantly BIDs result in additional levies to provide for additional services, although the general perception may be that there would be resistance to additional levies placed upon business. Further evidence indicating the willingness of business to pay additional levies in certain circumstances is presented later in this submission.

Engagement with Non Domestic Ratepayer

2.13 The multi-purpose nature of local authorities means that policies are set, and local spending undertaken, on a wide range of activities. Those services will include recognisable and traditional services such as education but will also include spending on economic development. The traditional role of elected representatives has been to

represent citizens, with only limited accountability to business. Good governance however requires that the local authority should engage with, and seek to be accountable to, all stakeholders. There will require to be debate between local authorities and business to ensure that a level of engagement, and therefore, accountability, appropriate to the relationship is developed.

2.14 Addressing the 'accountability deficit' by developing different models would compensate for the current democratic deficit, where businesses do not have a vote, and consequently no direct 'say' in local democracy.

In what way would local authorities benefit from this proposal?

2.15 It is helpful to consider how the current grant allocation system operates. It calculates a notional spending level for each authority, by reference to a range of complex formulae on the population, social structure and other characteristics of each authority's area. It then goes on to make an assumption about council tax receipts, reflecting the particular authority's tax base and an assumed national standard tax level.

2.16 The logic of this system is that, if all authorities were to set their actual budgets at the level of the formulae-determined notional budgets, they would be able to:

- provide and meet exactly the same levels and standards of service; and
- levy exactly the same council tax

2.17 This is the calculation which determines the grant position of the individual authority. Not only is a local authority's grant entitlement calculated in this way, but it is also fixed at this point. As a result, when local authorities consider actual rather than notional budgets, it is a fixed grant entitlement which is fed into the local equation. If the authority decides to set its budget at a different level than the formula-calculated level, any increase (or decrease) is reflected by the equation's variable source of funding, the local council tax.

2.18 The consequence is that a relatively modest increase in budget gives rise to a disproportionately large increase in the level of the local council tax. Local accountability is not served well by this relationship. Understandably, council tax payers relate any increase in their council tax bill directly to the increase in budget spending.

2.19 The potential benefit of the proposal to the local authority, and to accountability generally, is a reduction in this "gearing" effect and a partial realisation by the public of what local tax increases fund.

2.20 The Local Government in Scotland Act 2003 ("the Act") introduced a range of modernising powers, responsibilities and statutory duties. Most notably:

- Community Planning. The requirement to initiate and maintain a process whereby services are planned and provided after consultation; and
- The power to advance well-being. This power enables the local authority to, inter alia, incur expenditure which promotes and advances the well-being of the area. This includes the provision of financial assistance and the power to enter into joint venture arrangements.

2.21 These provisions clearly provide a legislative basis for a different relationship between local authorities and the wider community. The re-localisation of NDR therefore represents an opportunity, within the spirit of the Act, to re-establish effective links between businesses and local authorities. Effective links of this kind would complement authorities' community leadership and economic development roles.

What would the effect be on business of this proposal?

2.22 In 2004 CIPFA, in partnership with Rita Hale & Associates Ltd, published 'The Relocalisation of the Non-Domestic Rate – A Discussion Paper'. The paper was based on research undertaken in England & Wales. Findings from the research included:

- the domestic sector's contribution towards the costs of local government services increased faster than the non domestic sector's contribution over the entire period concerned; and
- if non domestic rates were to be returned to local control and the level of the non domestic rate multiplier linked to the ANCT for spending at FSS, the effect of this would be to raise the non domestic sector's contribution towards the cost of local services by about £400m (approximately 2.8%).

2.23 Significantly, the research concluded that business rates were not a significant overhead cost and that the impact of returning the non-domestic rate to overall local control would be barely perceptible. This is considered further in this submission, where the historic impact upon council tax payers is contrasted with that on non-domestic taxpayers.

2.24 The following table demonstrates the extent to which there has been a drift between the element of net current expenditure funded by council tax and non-domestic rates. This would appear to provide a measure of support to the 2004 findings from England & Wales.

% of Net Current Expenditure in Scotland								
	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05
Non Domestic Rates	20.5%	21.4%	21.3%	21.9%	21.6%	19.9%	18.4%	18.5%
Council Tax	20.5%	21.1%	20.9%	21.5%	21.3%	20.5%	19.9%	20.0%

Source: IPF statistics

2.25 The return of NDRI to local authority control presents local authorities with the opportunity to readdress the balance between the contribution of the domestic and non-domestic sector to the cost of local government services. The balance could be readdressed in a number of different ways – for example, parity could be restored between the respective sectors, with each making an equal contribution, or a 'gap' could be maintained, but of a smaller magnitude than the current contribution gap.

2.26 The Confederation of British Industry's stated position is that they favour the current approach to setting business rates. Interestingly, the interim report of the Lyons

Inquiry into Local Government has found some different views from businesses. The following statement is noteworthy:

"I would be willing to see change and local authorities collecting business rates locally – if local authorities were made more accountable then we would be willing to pay more"

2.27 The quote admittedly is not representative of the whole business community but it is perhaps indicative of a change in mood, consistent with the potential solutions suggested in this submissions and with the consequent impact on local authorities.

2.28 The remainder of the quote is:

"At the moment there is no accountability, no value concept or appreciation of what businesses are going through. The council taxpayer has a vote: the business doesn't have this"

2.29 So while there may be a mood change, business will not accept the return of NDR without a serious consideration of how to improve local government's accountability to business. The proposal for the member's bill does not discuss this. The final proposal should include consideration of this issue.

2.30 In 1976, the Layfield Committee set out 8 requirements of a satisfactory financial system. One of the requirements was:

stability – 'taxpayers, local authorities and the government should be able to rely on reasonably firm expectations about future commitments'.

2.31 It has to be acknowledged that one of the benefits of the current system from the business community's perspective is not only stability but also predictability of the tax. As an Institute, we consider that these factors should be a feature of the proposed re-localisation. In returning NDR to local authorities, there should be a link between the business rate and the council tax yields, which should be transparent to all and applied consistently.

2.32 In summary, the realistic and practical effect on business could be an increase in the contribution of business to the cost of local government. This would however need to be balanced against the positive aspects of representation and potential for influence over expenditure plans, with a more transparent realisation of the benefits which would accrue from that expenditure.

2.33 The extent of the increase would of course be dependent upon a number of factors. The final proposal needs to consider the relationship between council tax and non domestic rates. It should also consider how to improve the accountability of local government to business.

What effect would this proposal have on local authority residents?

2.34 The current balance of funding per se does not drive gearing. It is a particular detailed feature of the current system – the fact that it calculates and fixes grant at a notional spending level – which drives gearing. Under a system of re-localised rates, the consequences of any increased spending would be capable of being shared by the domestic as well as by the non domestic rate payer.

2.35 The return of NDRI to local authority control would alter the balance of funding but it would not eliminate the problem of gearing. At its simplest there is further opportunity to remedy gearing in making grant calculation variable, ie responsive to local budget decisions rather than fixed.²

2.36 The following table demonstrates disparity over a period of time between the increase placed upon non-domestic ratepayers compared to council tax payers.

Annual % Increase from Previous Year in Scotland							
	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05
Non Domestic Rates	8.2%	4.2%	5.4%	5.8%	2.1%	0.1%	6.2%
Council Tax	6.8%	3.4%	5.7%	6.2%	6.3%	5.0%	6.5%

Source: IPF statistics

2.37 In summary, the return of NDRI to local authority control offers the possibility to reduce the extent of the current burden on the domestic rate payer for any increased spending.

² Balance of Funding Review: papers for meeting 3
Paper 14 The Balance of Funding and gearing – exploring options for improving the current system

What would be the financial implications of this proposal?

2.38 The final proposal would benefit from clarity on the operation of the current “pooling” system. Following the return of NDRI to local government, is the intention to retain the current system of non domestic rate pooling, or is it to abolish it in its entirety?

2.39 The proposal states that:

“to ensure those LA’s who are net gainers from the current nationally pooled system do not lose out, the Scottish Executive will be required to both increase and adjust its Grant Aid Expenditure levels.

The proposal indicates that local Authorities with a large commercial base will benefit from this proposal, but should not experience executive clawback from the AEF settlement in other areas.”

2.40 The proposal would benefit from further exploration of how the new system will allow both the current net gainers and net losers to gain. CIPFA’s view is that the only potential means of achieving this will be from an overall expansion of the size of the local authority self financed expenditure. Local Authority self financed expenditure includes expenditure financed by local taxation as well as expenditure financed by non domestic rates.

2.41 If levels of self financed expenditure generated by a devolved administration grow significantly more rapidly than comparable expenditure in England over a period, and in such a way as to threaten targets set for public expenditure as part of the management of the UK economy, it will be open to the UK Government to take the excess into account in considering the level of grant to the devolved administrations.³

2.42 The re-localisation of the NDRI is potentially a complex financial matter because of the macroeconomic implications. These implications require to carefully explored further prior to finalisation by the member.

³ HM Treasury: Funding the Scottish Parliament, National assembly for Wales and Northern Ireland Assembly – A Statement of Funding Policy

Appendix 1 Relocalisation of the Non-Domestic Rate in Scotland

The following text sets out CIPFA's formal views on relocalisation of the non-domestic rate in Scotland. These comments, which formed part of the submission made to the Local Government Taxation Committee in March 2005, and should be considered against the comments made at sections 1 to 2 in this submission.

In CIPFA's view, the key issue preventing positive change to the current revenue grant system is the balance of funding between centrally provided and locally raised finance. If local democratic renewal and greater community involvement are to be achieved, it is essential that local authorities enjoy financial autonomy and accountability. This means that they must be responsible not only for raising the majority of the money they spend but for deciding how it is used to meet local needs and aspirations. If this were the case, authorities could be rightly held responsible for the decisions they take and for demonstrating community involvement and participation.

In CIPFA's opinion, what is needed is a fundamental shift in the balance between local and central tax raising towards a situation where more than half of local authority spending is financed locally. Under the current system, where only around 20% of local expenditure is financed through local taxation, local autonomy is severely constrained, particularly given that the Scottish Executive as the major funder seeks to exert influence over how funds are spent.

To have a positive effect, a change in the balance of funding would need to be accompanied by genuine local financial freedom. If the Scottish Executive continued to influence or to control spending patterns, changing the balance between the sources of funding would have only limited effect.

In addition to the effect that the balance of funding has on local autonomy there are significant behavioural implications arising from the overall level of funds under debate. As the Scottish Executive provides so much of local government's funding, clearly, decisions over how that total is distributed are crucial. Each local authority effectively has a duty to its electorate to be seen to gain as much of the available funding as possible. A direct result of this is that significant time and energy is devoted in most if not all local authorities to understanding and seeking to influence the minutiae of funding formulae.

The relative importance of the grant settlement can also have a distorting effect on policy decisions at the local level with local authorities less willing to follow avenues that could adversely affect the data upon which their GAE's are based.

In CIPFA's view, the most straightforward way of achieving a shift in the balance of funding would be to return the business rate to local authority control. CIPFA believes that this is the right course of action to follow, not only because of the greater financial independence and autonomy that it would afford local authorities but also because it would:

- re-establish effective links between businesses and local authorities to complement authorities' community leadership and economic development roles; and
- reduce the gearing effect of the council tax.

In setting out these comments, CIPFA does recognise that local authorities are not democratically accountable to businesses. There would therefore be understandable concern, however unfounded, that the return of a local business rate could provide opportunity to levy a higher relative proportion of increases in spending upon

businesses. Clearly, this would be as damaging to local financial accountability as the current position may be considered to be. CIPFA therefore believes that there should be a link between the business rate and the council tax yields and that this should be transparent to all and applied consistently.

The business rate base varies across Scotland. CIPFA would envisage a continuing role for the Scottish Parliament in equalising the resources available to local authorities in Scotland. However, in the interests of accountability and transparency, the impact of equalisation should be made clear at the local level. One method to achieve this could be the modernisation of the present council tax leaflet which at present accompanies council tax bills. A modernised document aimed at both council tax payers and the business community would provide a link between both levies and locally delivered services.

Clearly a number of issues would require to be addressed before the responsibility for setting the non-domestic rate for non-domestic properties could be returned to local authorities. Those issues would include:

- the relationship between the council tax and the non domestic rate. A current anomaly is that council tax valuation is based on the capital values of domestic properties whereas the non domestic rate continues to be levied on rental values;
- the approach to resources equalisation in the RSG system; and
- local authorities' accountability to the non-domestic taxpayer.