Service Design Working Group

Growth and Redistribution
Paper from DCLG

Aim

1. This paper explores options around how the system could balance rewarding growth and ensuring sustainable funding for local services. The working group will want to consider how to approach the issues raised in this paper in light of discussions on wider principles (earlier on the agenda).

2. The aim today is for the group to agree broad approaches to the design of the system. The next stage is to use outputs of models to demonstrate what the impact of these approaches might be - DCLG officials are working towards this.

Interaction with Needs

3. It is more than 10 years since the formulas used to define local authorities' needs were last updated. There is good reason to believe that the demographic pressures and other cost drivers have affected different areas in different ways. A key element of the move to 100% Business Rates Retention is the Fair Funding Review which will reassess the way relative need is measured. The Needs and Distribution working group are focused on this element of the reforms.

4. The outcomes of the Fair Funding Review will establish the funding baselines for the introduction of 100% business rates retention. The work of this review is still at a very early stage and no decisions have yet been taken about how need will be measured in the new system. However regardless of how we measure need a key challenge for these reforms is finding the right balance between providing a strong incentive for growth in local areas while ensuring funding is sustainable for all local authorities. Updating funding every year to reflect changes in need means there is little incentive for local authorities to grow their own tax bases while never updating needs risks making some local authorities unsustainable. Through this paper we are looking for your views on the some different approaches to meeting this challenge.

Resets

5. To find the right balance between rewarding growth and sustainable funding, we expect to need to 'reset' the system on a fixed basis, to allow us to reconsider relative need and to reset the redistributable amounts (top-ups and tariffs).

6. The alternative to having fixed reset periods would be for an automatic but variable system, whereby resets could be 'triggered', possibly based on indicators such as the number of authorities requiring safety net payments. Our opinion is that this would be too uncertain for local authorities, who would not have the clarity of timings to utilise growth in the system on long term projects.

Do you agree that we should have fixed reset periods?

7. On the one hand, depending on the services devolved to local government as part of the new system, adjustments to redistributable amounts may need to be made frequently to reflect changes in relative needs. There is a risk that redistributing too infrequently could result in authorities not being able to deliver services where relative need grows faster than local tax resource.

8. On the other, changes made too frequently weaken the incentive for growth, and may reduce the confidence of local authorities to build achieved growth into their base budgets, or use that growth for long-term investment. This is exacerbated if the growth that local authorities do achieve is included in the quantum of funding that is to be redistributed when the system is reset.

9. As local authorities under the new system will be heavily dependent on business rates income for delivery of core services, we think it’s right to set fixed reset periods to give authorities certainty of income. But there is a wide spectrum covering how frequently resets are carried out. The examples set out below are for illustrative purposes, and should not be considered as suggested ‘options’.

   Illustrative examples of resets

   a. **Frequent full resets of the system**, including all achieved growth (eg every 3 years). This would ensure that business rates income was frequently redistributed to meet changes in relative need, and that local authorities would retain a ‘growth incentive’ for the three years between resets.

   b. **Infrequent full resets of the system**, including all achieved growth (eg every 20 years). This would set a single baseline for local authorities based on their relative need at a fixed point in time. Any growth local authorities saw during this period could then be incorporated into budgets. However, any reduction in income would also need to be managed by a local authority, who could see income reduce and affect the delivery of local services. This approach could mean that some local authorities are heavily dependent on the safety net for an extended period.

   c. **A partial reset of the system on a frequent basis**. This would mean that a proportion of the system (including a proportion of achieved growth) would be reset every 3 years to adjust for changes to relative need. The other ‘portion’ of the system (including a proportion of achieved growth) would be reset on a much longer timescale – (eg 15 years or never). This option would give authorities a much greater incentive for growth than (a) but give some greater protection for services than (b).

Partial reset

10. Further detail about how a partial reset option set out at (c) above would work:
    - On day 1 the entire quantum of business rates income would be redistributed according to an assessment of relative need.
    - Thereafter, a proportion of the resource – which could represent the resource needed for specific demand-led services – would be reset at relatively frequent intervals. This

would be on the grounds that the relative need for such services is more likely to change frequently as a result of demographic or other changes.
- The remaining portion of funding would be reset only infrequently, and authorities would be entirely dependent on their growth in local taxes for increased funds to deliver other services.
- Under this option a proportion of growth would be included as part of a regular reset, and a proportion would remain with the local authority on a longer term basis.
- This would give local authorities a strong growth incentive that would be maintained across resets, and a greater confidence that a proportion of growth could be used for longer term investments.

11. The key outstanding question for this approach is what proportion of funding might be reset. This question will require further work, to be informed by the work of the Fair Funding Review group, about the possible proportions that could be reset, and the impact this would have.

What is the group's initial view about the reset approaches set out above?

Is the group able to reach consensus on a preferred approach (with recognition that further detail will need to be considered beyond this)?

<u>Redistribution between local authorities</u>

12. We have always been clear that we will still need a system of redistribution between local authorities to balance revenue with relative need. The Fair Funding Review will identify relative need for each local authority and we will need to find a way to redistribute business rates income according to that.

13. Under the 50% system, we have used a system of top-ups and tariffs to redistribute funding from those local authorities that collect more in business rates than their identified need, to those who do not collect enough for their need. We expect to use the same type of system under 100% business rates retention.

14. The top-ups and tariffs that each local authority could expect to see will be calculated before the new system is introduced, based on the Fair Funding Review and an assessment on their expected business rates income. Top-up and tariff payments would be fixed for the period between resets to give local authorities certainty about their baseline funding level.

Is the current system of tariffs and top-ups the right one to continue? Are there alternatives that the group would want to see represented in the consultation document?

Distribution within Mayoral Combined Authorities

15. Directly elected Mayors have democratic accountability to their area, and we know that some have expressed a wish to be given greater responsibility for the distribution of resources within the Combined Authority area.

16. We are interested in exploring whether a Mayoral area (which covers multiple local authority areas) could be given a single ‘baseline’ of relative need, and therefore a single tariff or top-up based on the wider area. A future safety net would also operate at this level – ie the safety net threshold would be based on the Combined Authority’s baseline. The Mayor would then be responsible for distributing resources within this wider area.

17. The aim would be to help stimulate coherent decision making across local authority boundaries, with growth gains being generated and used at a strategic level.

Should Mayoral Combined Authority areas be given additional powers and incentives, as set out above?

Should these powers be available to other devolution deal areas without a directly elected Mayor?

Could this approach also work for local authorities that choose to come together in an agreed ‘pool’?

Distribution in other areas

18. In other areas, we would have to continue to set tier splits – i.e. the percentage of business rates income that each tier of authority would get. There are a wide range of options for how these tier splits could be set, which will need a further discussion alongside some modelled examples at a future meeting. Future work will need to consider tier splits in the context of the responsibilities to be devolved to areas, and to which tier they are devolved.

19. Where Fire and Rescue Authorities exist as a separate tier of authority, we expect the system to work as it currently does.

What has been your experience of the current tier splits? What changes would you want to see under 100% rates retention?

Would any two tier authorities be willing to provide a paper to the group demonstrating the impact of current tier splits and any suggested changes?