



Communities and Local Government Committee

Oral evidence: Business Rates, HC 665 Monday 22 February 2016

Ordered by the House of Commons to be published on 22 February 2016.

Members present: Mr Clive Betts (Chair); Bob Blackman; Helen Hayes; Kevin Hollinrake; Mary Robinson; Alison Thewliss.

Watch the session

Evidence from witnesses:

Questions 1 – 48

Witnesses: **David Phillips**, Senior Research Economist, Institute for Fiscal Studies, **Dr Kevin Muldoon-Smith**, Associate Lecturer and Researcher, Northumbria University, and **Simon Parker**, Director, New Local Government Network, gave evidence.

Chair: Good afternoon. Thank you very much for coming to this, our first evidence session in the inquiry into the Government's business rate reforms. I apologise for keeping you. It was not that we were spending more time trying to make the questions harder; it was simply that some Members were still in the Chamber listening to the beginning of the Prime Minister's statement on the European referendum, so that was why we got a bit delayed starting, from our point of view.

Just to put on record interests that we may have, I am a Vice-President of the Local Government Association.

Helen Hayes: I am a councillor in the London Borough of Southwark and employ a councillor in my staff team.

Q1 Chair: They are our interests. Could you please begin by introducing yourselves and saying which organisation you are from?

Simon Parker: I am Simon Parker, Director of the New Local Government Network.

David Phillips: I am David Phillips. I am a Senior Research Economist at the Institute for Fiscal Studies.

Dr Muldoon-Smith: Kevin Muldoon-Smith, R3intelligence, Northumbria University, lecturer and researcher.

Q2 Chair: Thank you very much for coming. Just to begin with, the Government are now talking about 100% retention of business rates by local authorities. We have had, for the last three years, 50% retention. Do you think we ought to be learning some lessons from that? Is there anything at that stage, three years on, that we can actually learn? Are there clear results that we can identify and say, "That has happened because of the change to 50%", and therefore look forward on that basis?

Simon Parker: I will kick off. I am not aware of such lessons. They may exist, but I have not come across them. In general, the feedback from surveys and conversations I have had about 50% retention is that it has not been that much of a big deal for local authorities. The incentive is not that sharp, really. Of course, councils would rather have more money than less, so at the margin it may have made a difference somewhere, but I have not seen any local authorities telling me that they are behaving fundamentally differently because of the 50% retention.

Of course, we have to remember that the 50% policy was introduced at a time when local government had rather more money from central Government, so there was more RSG and central money to cushion the blow. As RSG is taken away, it is entirely possible that the combination of less central funding plus a sharper incentive—and 100% retention would automatically be a sharper incentive—would make more of a difference. I guess what I am saying is that the 50% retention was not that ambitious, as it turns out, and was fairly dampened within the overall finance system, over the past couple of years. That may well not be the case going forward.

David Phillips: If I can add on that, one of the issues is that it is almost too soon for us to tell with this 50% system. It came in, in 2013, and we do not have full outcome data for more than two years yet for the new system, so it is too soon to say, in one respect. We can learn some lessons from it, maybe not in terms of its impact on business growth, but in terms of some pitfalls that need to be avoided when designing the new system of 100% retention.

One of the features that was built into this 50% retention was that, in 2020 and then every 10 years, there would be a reset of the system and any growth that had happened over that period would be reset and the money redistributed across the country, on the basis of need and

funding formulas. Doing this every 10 years can distort incentives because, at the start of a 10-year period, you would have very strong incentives to grow your revenues. In year 9 or 10, you do not, because you would lose that revenue in a subsequent year. You might want to hold off development for a year or so, so you get to keep it for 10 years. That is one of the systems in place under 50% retention that DCLG is consulting on to have something different. We can learn some lessons from that.

I would also point out that for many authorities it was not 50% retention; it was 25% retention, because of the system of levies and safety nets that operated to stop people losing out too much. They funded some safety nets by effectively capping the amount that rich authorities could keep at 25%, as opposed to 50%.

Dr Muldoon-Smith: If I could just add, the learning outcomes of the last couple of years have been about the difficulties of administering the system. One of the problems for the local authorities that we have worked with is the fact that any growth they have potentially been able to make has effectively been lost by the value of any cost of potential backdated revaluation appeals. Let us say there are 3,000 appeals currently live in the system. A lot of the authorities are finding that any extra money they can make on top of the business rates is counteracted by the rateable valuation appeal process so, in many ways, any growth incentive is almost being lost because of the uncertainty created by the rateable valuation appeal process.

Q3 Chair: We will come and have a look at that in a minute. David, you mentioned there a potential flaw in the current system that Government might have a look at when they go to 100% retention. Are there any other issues in there, so we might at least learn how not to do things from the way the 50% localisation was done to try to make sure it works better when we go to the total?

David Phillips: I am not sure it is necessarily a flaw, but one issue that might need consideration is the split between districts and counties in two-tier areas. In effect, of that 50% retention, they are saying that districts would keep 40% and the counties would keep 10%, the idea being that the districts are the ones that make most of the decisions around development of the planning system. Now, that could be appropriate but, actually, in the new system that might want to be reconsidered. We might come on to it a bit later.

That interacts with the way in which you still need to redistribute money around authorities. If you continue with this, given most of the business rates are at districts, in order that counties do not lose out, you basically have to take some of that money and give it back to counties. There are these big flows between districts and counties that

arise. I am not saying that it was necessarily a flaw in the old system, but it is something. The share that districts and counties take is something that DCLG will have to think about and that this Committee might want to think about.

Q4 Chair: Is that also compounded by the fact that districts make the development decisions, whether it be building houses so council tax comes in or developing industry and commerce, but the growth pressures in service probably come from social care, which is a county function?

David Phillips: We can come on to that issue a bit later as well maybe, but that is exactly the kind of issue I am thinking about. If it is the districts that are keeping all the growth in business rates, and some of that is being redistributed to counties, but not all of it, and it is the counties that are facing the spending pressures, you can get exactly that situation. The district budgets have been doing relatively well, but the counties are struggling to keep pace with the spending demands put on them. That is the issue spot on.

Dr Muldoon-Smith: In terms of improving it, there is no easy way to do it. One of the major findings we have found is that it is very difficult to leverage any value from your existing built environment. Local authorities already gain tax through empty property rates. Effectively, any growth in value on business rates is equalised out of the system after national valuation, for instance, so you can only really make money—I am talking about growth—in terms of net new construction of floor space. Not all areas can do that.

Coming back to the empty property rate issue, this is more of an issue with the empty property rate system rather than business rates, but under business rate retention local authorities make more out of vacant properties than they do out of properties that actually have businesses in them. As crazy as that sounds, it is the wrong incentive for me, when we are supposed to be talking about economic growth.

Q5 Alison Thewliss: Just to talk about some of the reforms that have been proposed, there is not an awful lot of detail yet behind some of the areas of reform. What kinds of areas do you think need clarification? What clarifications should be the first to be brought in?

David Phillips: Two fundamentally important questions need answering on this. The first is what mechanism, if any, is put in place to stop divergence in funding growing exponentially. In effect, do they stop authorities gaining, gaining and gaining, and stop authorities, losing, losing and losing from the system? There is something a bit like the system of levies and safety nets that they have under the partial retention system. DCLG has said that those levies and safety nets are

going to go, and they are going to think about what, if anything, should replace them. That is very important because, without them, you could see very big divergences in funding. Just how those work can have big effects on incentives. As I said, if they reintroduce this one that had a fixed 10-year or five-year cut-off, you get skewed incentives delaying development a bit to get into a more favourable time. On the other hand, without it some place could lose out indefinitely. That is one area: what to do to prevent divergence getting bigger and bigger.

The second is what to devolve to local authorities, because there could be very big interactions. To put it another way, there could be correlated risks when it comes to your revenues and your spending. Say, for instance, you were to devolve more age-related spending to local government. Some parts of the country with more rapidly ageing populations would see their spending pressures go up. They are also likely to see their revenues fall from business rates, as there are fewer workers in the area and potentially less consumer spending in the area. The other thing is to get some clarity on the areas they are thinking about devolving, so we can start to analyse whether these business rate and council tax revenues they have in the future are the right ones for those spending areas.

Q6 Alison Thewliss: That is very similar to the debate we are having in Scotland just now about the fiscal framework and the principle of no detriment, with what you have said now and what actually happens once you have those powers and the ability to raise money as well. It is really interesting that we are seeing this reflected here as well. You have also spoken about the evidence base that we have a couple of years out from the 50% retention. Do you think it is the right time to do this, if we do not have the evidence base to see how that has worked?

David Phillips: I am not sure I would want to comment on that. I would say that the Government initially said it would consider the case for further retention based on the evidence. There is a question for DCLG on what evidence they have used in coming to this policy, so I would put the question to them, rather than to myself.

Alison Thewliss: That is fair enough. Have you guys got anything?

Dr Muldoon-Smith: There is additional unanswered detail on two areas for me: safety net funding, very simply, and then, comparing it to the Scottish situation again, the local planning ability to lower the rate. It is whether that will have any flexibility in it or just be uniform across the local authority area. Certainly in Scotland they have the power to target certain sectors, certain locations and certain types of property. If those powers were in place, more locations would be able to exploit that potential system. If they are not in place, the only real locations that would be able to exploit that would be those local

authorities with a budget surplus that are in a position to look at it. Imagine if you can start incentivising certain sectors. Certainly local authorities are going to use that to feed into their regeneration schemes and stuff like that, so I would certainly argue for greater flexibility. It is a win-win.

David Phillips: Could I come back on that question about whether it is too soon? I am not sure whether waiting would have really provided us with the evidence about whether this policy was successful or not. What we are trying to do is work out what has happened now, with this system in place, and what would have happened if we had kept under the old system. That is always very hard to do. If we had waited another two or three years, we might have had a bit more evidence, but I am not sure whether it still would have been easy to make this judgment call, even then.

Simon Parker: To build on that point, I also wonder whether the evidence you would get from 50% or 25% retention would have really told you very much about what would happen under 100% retention. Under the current system, the growth incentive is not very sharp at all. This builds on David's point from earlier about what systems would be in place to ensure equalisation. We have to be very careful in thinking about ensuring the growth incentive is sharp enough on the other side of that. The clear design challenge here is to build a system that equalises enough to be fair, while also giving people enough of an incentive to grow their local business rate base. That is a very hard thing to get right and Governments generally default to somewhere in the mushy middle. If they do that, the system will look an awful lot like a less well funded version of what we have now. Governments probably have to choose whether to go for a less fair system that incentivises national growth overall, or a fairer one that sacrifices that growth incentive.

David Phillips: May I come back with one final thing on that? That is a key point there. The important thing to recognise is there is almost an inherent trade-off between equalisation, on the one hand, and incentives, on the other. That is a trade-off that is difficult to avoid, but what might be worthwhile thinking about is when it is that growth incentives matter. You could have two kinds of systems: those that give weaker incentives but for longer, so you get to keep somewhat less of the revenue but for more years, or you get to keep all of the revenue, or more of it, for a shorter period of time. Thinking about what would matter to councils more, this immediate bigger incentive or a longer slower incentive, could be worthwhile.

Alison Thewliss: There is a prospect of that giving more certainty.

David Phillips: Potentially, yes.

Q7 Alison Thewliss: In terms of the needs assessment that is done, there are places that may feel as though they are going to lose out on this, perhaps because the needs that they have are not being taken into account. What is your view on how long a review of a needs assessment might take and what factors might that assessment take into account, or what should it take into account?

David Phillips: On that, I would say that we have traditionally had a needs-based assessment in use in England, which was updated every year until 2013, when they moved to the partial rates retention system. It is still updated every year in Scotland and Wales, I think; presumably they could bring in an updated version of that. One of the criticisms of that system was that there were hundreds or thousands of indicators in there. It was very complicated, people did not really understand it and there was potential to game it. There may be some scope to simplify that but, of course, if you simplify it, then people will say that you are not taking account of all the relevant factors, so it is very difficult. Probably the best place to start is to update the one they have already and consult upon that.

Simon Parker: It strikes me that again you have a trade-off here between frequently bringing need back into the funding system and allowing people to keep the proceeds of growth. Again, it is the trade-off between fairness and incentive here. To my mind, the idea of a 10-year reset system, which was originally proposed for the current system, was a sensible one. 10 years is probably the minimum time over which councils could use that money to borrow against. At 10 years, you can borrow against it, but it does not allow too much divergence in the current system. Obviously we await details of what 100% retention will mean.

Dr Muldoon-Smith: In some ways, the shorter the reset period the better it is for local authorities that have lower business rate bases and want to immediately reassess their needs. The ones that are doing really well out of it will want the reset to be a lot longer, exactly so they can borrow and then start investing in their local areas. I guess there are two different issues going on there, are there not? It is how the reset process works.

David Phillips: "Trade-off" is the important word.

Q8 Chair: I have two points to pick up on that. In terms of reset, something we looked at in our inquiry in the last Parliament is whether it is possible to differentiate between growth in the business rate that comes directly as a result of a decision an authority takes to approve development, as opposed to an increase in business rate that comes

simply from higher values coming from the general growth of values in an area? Parts of London have done incredibly well in the last few years relative to parts of the North.

David Phillips: As I understand it, that is precisely what the current system and what the new system will try to do. As Kevin said, these systems effectively only allow for councils to keep growth that is a result of new development, whether that is a new building being built or a building being refurbished. What happens to that other growth? The growth in the UBR, the uniform business rate, gets taken away because the system of tariffs and top-ups redistributes around local authorities, so that does not affect it. When there is then a revaluation and the values go up, that is also stripped out, because DCLG has already said that any gain from revaluations will be redistributed across authorities. Come 2017 when there is the revaluation, parts of London do not see massive increases in their revenues and parts of the North East or other areas, which have seen falls, do not see big falls. We already know that these increases in value are going to be stripped out of the system.

The trade-off with that is that there are two ways in which you can boost your economy. One is to get new development by building new buildings. The other is to increase the value of your existing business stock. If you want to protect them from these kinds of valuation charges, you are also not giving them the incentives to move up the value chain.

Q9 Chair: There is one other thing. You mentioned, David, that the way to build incentives in is either less over a longer period or more over a shorter period. Does that have any consequences for how you might do equalisation?

David Phillips: Yes. If you have a system in which you try to prevent complete divergence, the other way of saying that is that you are trying to have some degree of equalisation. You could say that you allow local areas to retain all of the growth for five years before you do an equalisation reset or you could say that they could keep half the growth for 10 years before you do a reset. That is a trade-off. The Government are saying this is 100% retention but, if they want to keep a degree of equalisation, implicit in that is that it will be less than 100%. We should have that in mind as well. If you want some equalisation in the background to stop divergence that inherently means, in the long term at least, that it cannot be full 100% retention.

Q10 Helen Hayes: How reliable a source of revenue for local authorities do you think business rates will be? I am thinking particularly of a scenario, for example during a recession, when the income from

business rates might drop, at a time when needs within a local population might be going up. What do you think are the risks?

Dr Muldoon-Smith: Almost perversely, because landlords pay empty property rates, under the current system, they will almost get more in a recession. The business is not paying tax and the landlord will pay the empty property rate tax, which is generally higher than what a business pays. I come back to my argument earlier on; in many ways, you can almost make more money in a recession than you can in a growth area, which is one of the crazy areas in the thing. It is a little bit perverse.

In the short term, it is quite secure because of the way the system works. In the longer term, over 15, 20 or 30 years' time, property as a basis for tax will change. Maybe 15 or 20 years ago, there was a good correlation between productivity and floor space. As we move on, with internet trading, when we can work anywhere and everywhere, with BlackBerrys, coffee shops and that type of stuff, tax on property is not necessarily going to be as relevant in the future. Businesses want more from less floor space, so it will be a little about how much you can make from property. I do not think it will be as much in the future. That is why we have to start looking at different types of taxes, I suppose, on business outgoings and such.

David Phillips: Those are really good points. In the short term, there could still be some hit. Even though there are empty property rates, there is a short period when no rates are liable. There will be an initial hit to revenues during a recession but, as Kevin said, it is in the longer term that there is potentially more risk from this to local authorities. The risk in the longer term is that space becomes redundant and then is demolished. For instance, you have a big factory in your area that has big rates liabilities. The example I gave before is Port Talbot. The rateable value of the steelworks there is half the county's rateable value. If that goes empty in the short term, after three months they will get their money back but, if they demolish that, it is lost. The long-term process of economic and structural change is what business rates expose local authorities to, in terms of risk. They have not faced that so much in the past.

Q11 Helen Hayes: Do you think there are risks associated with what we might call a democratic deficit around business rates? Most councils spend about 75% of their income on children's and adult's social services, which are not services that most businesses typically benefit from. As a businessperson, you might see the benefit of those services individually, but your business does not see the benefit of those services and yet business will be the biggest funder of those services. Do you think there is any risk around businesses placing more demands on local

authorities and more pressure to spend their money in a different way, which might change the dynamic?

Simon Parker: It is a very good question and the answer is probably that we do not know yet. The thing with what is happening at the moment is that we are talking as if we are localising the business rate. In fact, what we are doing is giving councils the ability to retain and to lower it, but they cannot raise it. In that context, the democratic interests of businesses in the rate are limited to trying to get it lowered. They could lobby for that but, because the council cannot raise it, I am not sure if business would take that much more of an interest. You are right that, if they did take an interest and start demanding things, when councils are being forced to spend more and more of their money on those care services, which are not the ones that business want, you could see a mismatch between businesses asking why they are funding not so far from half of the revenue, when actually most of that money is going to pay for things that they do not use. It is certainly a possibility.

Q12 Helen Hayes: Finally from me, do you think that, at this stage, given a lot of the uncertainty that there is around business rate retention at 100% and how it will work, there should be provision for Government to reintroduce grants or a review mechanism that could trigger the reintroduction of grants, if some of the risks proved to be too big for councils to bear?

David Phillips: Yes.

Dr Muldoon-Smith: It would be sensible, yes.

Simon Parker: It seems to be inevitable in the sense that you get to 2020 and you look at where local government funding will be by then. Councils are going to be pretty threadbare places, and the business rate and council tax will not meet the full range of local need. The idea that we have permanently said goodbye to central grants is not credible. One way or another, it will come back in. It will have to.

David Phillips: As I have said before, there is a correlated nature to these risks, in the sense that those areas that might be seeing the highest increases in demand for their services and their spending—those that have an ageing population or a population becoming more deprived—are also going to be the areas that are seeing less growth in their business rates. An older, poorer population will generate less employment and less demand for that.

In that context, you might want those areas that are seeing particularly challenging financial circumstances to have a system of grant funding as a backstop, especially if central Government is going to want to

influence what services are providing. For instance, with the Better Care Fund, we saw just recently that they wanted local authorities to prioritise social care. That has vastly different costs across different areas of the country. They can do vastly different amounts from their own resources of council tax and business rates. Maybe in those circumstances, you would need to have a grant, when additional responsibility is being imposed on local authorities.

Q13 Chair: Presumably, just taking that one step further, if you had an extra element of grant, you could use that element to deal with the redistribution problems to a degree, which might simplify the business rate system.

David Phillips: Potentially, yes.

Chair: You do not sound too sure about that.

David Phillips: It would simplify the business rate system and the way that that operates. It would, for instance, simplify the system of tariffs and top-ups. I will not bore you with the details of that, but the implications for incentives and equalisation are such that the trade-offs that exist would still exist. Whether one is labelled as being a grant and one is being labelled as a tariff and top-up by the business rate system, the practical implications would be exactly the same. It would just be a simplification of the structure, in that regard, a more flexible structure. The grant would be a more flexible structure than trying to do it via ad hoc adjustments to the business rate system itself.

Simon Parker: It seems to me that having a business rate retention system that incentivised growth in a sharp way, with grant off to one side acting in a redistributive role, might well be where we end up. That seems very sensible to me: to have one part of the system that redistributes and one that incentivise growth. The fact that the Government are trying to do both within one system will inevitably be very difficult to pull off.

David Phillips: It is at least confusing for people to understand.

Simon Parker: Yes, it would wither be very complicated or—

Dr Muldoon-Smith: That is the broader issue with business rate retention, is it not? It is the complication and the esotericism of it all. It is very difficult to get a grip on, if you want to sell it to local authorities and people who live there. People have not really brought into it yet, I do not think. It is going on, but top-ups, tariffs, safety nets and everything are all a bit alienating sometimes.

Q14 Bob Blackman: My apologies for having to walk out during some of your evidence; I apologise if you have covered some of my questions previously. At the moment, the Government are seeing the transfer from revenue grant to retention of business rates as a cost-neutral arrangement, yet one of the concerns that is expressed quite widely is that the Government can flex the grant to meet some of the challenges. How flexible do you think this system is going to be, given that a lot of the decisions have not yet been announced, even if they have been made? Have you any reaction to that?

David Phillips: Is that flexibility in terms of flexibility to respond to changing circumstances and the differences in circumstances across authorities?

Bob Blackman: One of the problems is that, if you have a local authority with a low council tax base, a low business rates base and then quite a chunk of government grant, their ability to grow their base is very limited. There is a problem there, and then we get into top-ups, tariffs and such. At the moment, the position is that the Government find a way through a very complicated formula, which only three people actually understand. One is mad, one is dead and the other one operates it. I defy anyone to understand this formula completely, and I do know the machinations of how some of these government grants are distributed. You fiddle with the figures and then churn out the figures: "Ah, I haven't got the right sums, so let's change the parameters." That is not going to be possible in the future, is it? What is the impact for both local authorities and Government?

David Phillips: I would answer that in two stages. You mentioned tariffs and top-ups. At the first stage, I would say that central Government can use tariffs and top-ups so that no one will lose out initially from having lower tax bases. For an authority that has a low council tax base and low business rates tax base, the Government can set the initial tariffs and top-ups so that they do not lose out in that first year. You are right that, in subsequent years, it becomes more complicated.

Bob Blackman: For a 10-year outlook, or however long it is, they will continue to lose out.

David Phillips: In subsequent years, it is harder for those authorities to grow their own revenues, because they have smaller tax bases themselves, and it is harder for Government to compensate for that by using grant to boost these councils' own revenue-raising abilities. It could try to do it by playing with the tariffs and top-ups, but it is potentially not transparent to do that, or it does not do it and these authorities are left in a bit of a difficult situation. That is why we are saying that maybe, in certain circumstances, there would be greater

clarity and greater flexibility if there was still some kind of separate grant system in there, so you could do that more flexibly.

The social care sector provides an interesting example here. From increases announced in the budget, councils are getting money in two ways for more social care. First, there is a social care levy on the council tax of 2% a year, for the next four years. We looked at that at IFS and showed that some authorities can raise much more from that than other authorities.

Q15 Bob Blackman: Is that because of the council tax base?

David Phillips: It is because of the difference in the council tax base and the rates, actually, they start with. Wandsworth can raise the equivalent of about 5% of what they spend on adult social care from these increases. Rutland can raise about 16% of what they currently spend on adult social care from these increases. That is a big difference. What the Government did is to use the Better Care Fund grants that it announced at the same time to even out those differences, so that everyone can have the same increase in their adult social care spending. Without a grant, how do you do that? You could try messing with the tariffs and top-ups, but that could be complicated and not transparent. Nobody knows what you are doing. You are right that there could potentially be an issue there, but that is the trade-off from trying to move to a system where you have more incentives. You are doing less to address councils' needs at the same time.

Q16 Bob Blackman: The Chancellor announced the abolition of the uniform business rate. Is there a case for saying that the business rate should be different in different parts of the country and charged as such?

Simon Parker: Yes.

Q17 Bob Blackman: How should that be done? Should it be regionally? Should it be by local authority? How could that be done? At the moment, that seems to be a silent aspect of what the Government are proposing.

Dr Muldoon-Smith: You would need to start bringing in things like functional economic areas and property market dynamics, because neither really recognises local authority boundaries. If you were going to start contemplating it, you would need to start looking at some different geographies, and that is no easy task when you are trying to get local authorities to work together.

Simon Parker: In a sense, the Government have conceded the point in a small way about business rates, because mayors of combined

authorities will be able to raise 2p from the business rate for infrastructure.

Q18 Bob Blackman: They can raise 2%, but that is not really changing the overall business rate structure. That is the fee based on the business rate. Is there a case for saying that the business rate should be different in different parts of the country, and then the rate at which you charge it can vary?

Simon Parker: I would say very powerfully that yes, it should be. You are right, and Kevin is right to talk about functional economic geographies. The idea of all 10 Greater Manchester districts each setting their own business rate seems not to be a brilliant idea, economically and administratively. On the other hand, the idea of Greater Manchester as a whole having control over its business rate strikes me as making lots of sense. It is a unit with which business can identify. If it is right to devolve the business rate and right to abolish the UBR, why is it not right for councils at least to have the same control over that as they do over council tax? Why should business rate payers have a deal that residential payers do not get?

David Phillips: I was going to add that this is about the rate that is set, because the underlying tax base does reflect the differences across the country. It is based on values. If values differ across the country, it automatically reflects those differences.

Q19 Bob Blackman: These are historical values going way back when.

David Phillips: Every five years they get updated, although it has been seven years this time because of the delay. I was going to say that that is a key question, actually. The LGA has said that it thinks there should be flexibility on this. That comes back to Helen's question about whether there is democratic accountability in this context, when businesses are not voters, for instance. That is the trade-off that is being played here. You can give councils more flexibility, which would be good for their accountability to council tax payers, but could it be problematic if they used business rates as a cash cow because businesses are not voters? I do not know the answer to that question. That was a concern back in the 1980s when they abolished the old system and had the UBR. That is the kind of question that needs to be thought about again in this context.

Q20 Bob Blackman: The final thing from me is that, given that these changes are happening and that they will eventually come in, in some shape or form, we are going to get to a position whereby the local

authority's income would be council tax and business rates, and they will bid for anything else. There will possibly be other streams of money that they bid for, but that will be their basic source of income. Clearly there is going to be growth in some areas and decline in others. Who should manage that? Is that a role for central Government or should local government come together and arrange the formulaic arrangements to take into account the people who are losing and gaining? What is the role of central Government in this?

Simon Parker: You asked if it is local government or central Government, and the answer is inevitably that it is both. Particularly with the new combined authority structures, you now have a situation where it is not unreasonable for central Government to say to cities, "Here is your top-up as a city", or "Bye bye to your tariff; you will account for how you want to distribute money within your city. If there are poor parts of the city, it is partly your job as a group of authorities to sort that out." It strikes me that, in Merseyside for instance, the whole argument around the economy for a city like that is that parts of it will grow and there are parts that will not. It seems to me that, if we are generating business rates off the areas that grow, some of that money should find its way back to some of the poorer parts that need help.

Equally, it is clear that we are moving away from a highly redistributive system of the kind that we saw in the 2000s. We are moving into a system where there will be more risk and where some areas will be left behind. Some areas will get left quite badly behind, it seems to me. In those areas, there is a role for central Government to step in and offer some support, on an area basis. There is a strong case for central Government to develop programmes to put the economies of those places back on some sort of workable footing. If you are Knowsley on the fringes of Merseyside, do you need another 40 or 50 years of subsidy or do you need an economy that works? It strikes me that the kinds of interventions we might need to see are ones that enable places to pay their own way better.

Q21 Bob Blackman: In many ways, if you look at the areas of deprivation now, they are very similar to areas of deprivation going back tens and twenties of years. Why should the Government not say, "We accept that. That has happened," and let the areas of growth grow and produce the goods, while the areas that fail decline? Why should there be a featherbedding of areas that have not been successfully regenerated?

Simon Parker: While I probably share some of your unrest about place, it is less about people. I do not think it is fair to say that the people of Knowsley that they must just be left behind. If there is to be an answer here, it has to be about ensuring that those people access

good jobs and opportunities, which may mean better transport links to the centre of Liverpool or it may mean money to invest in jobs and businesses in their area.

Q22 Bob Blackman: Is it not true that what tends to happen in areas of deprivation is government money or local authority money is put in, then people get jobs, they improve their lot and the first thing they do is move out to be replaced by more people who are in the same deprived circumstances? We just create a less-than-virtuous circle.

Simon Parker: The goal must surely be to break the circle.

Q23 Bob Blackman: Governments of all persuasions have failed to break the circle over a very long period of time. We had Newham authority in front of us, which has had government funding in London for donkey's years. They project that they still need the funding to continue for 30 or 40 years, because they are not going to break the deprivation otherwise, by which time we will probably all be dead.

David Phillips: This comes back to the issue I mentioned earlier of trade-offs. There is a trade-off between the incentives for growth, which would suggest that you did not want to redistribute revenues towards those areas that are struggling so much because, by doing so, you are blunting incentives to grow and taking resources from those growing areas that could potentially use them to grow even more quickly. That is one side of the equation. The other side of the equation is that most governments consider a role of redistribution, so that certain groups do not fall behind.

What you have seen in the UK is a move from a system that, at one extreme, under the traditional local government finance system, was based on needs with no reference to revenue-raising capabilities. A low tax base area was fully compensated for by getting a bigger revenue support grant to compensate that. As your needs change, that was updated, not perfectly but at least to some extent. The system in the future could be moving much more towards the other extreme. It is just a question of what kind of country the UK is and how you trade off redistribution versus growth. It is the question that plagues us, whether that is income tax or corporation tax policy. It is also about local government funding formulas.

Simon Parker: The way that I observe cities trying to square that circle and to break the cycle of deprivation is to try to answer that question of how business growth relates to social need. What cities like Manchester have worked out is that the way you run your public services and ensure public wellbeing links directly to a more inclusive type of growth. The model you are seeing being developed in Greater

Manchester and other cities is very much about saying that we will reform our public services in ways that make people more ready to get decent jobs. We will reform the way that we do business support and the built environment. We attract businesses, so that there is a better stock of jobs and high-productivity jobs. Hopefully, by moving people out of deprivation into those better jobs, we create a virtuous cycle of inclusive growth and social wellbeing. Over time, that reduces demand on our public services and increases our revenue, so that at some point those two numbers meet in the middle.

That is quite conceptual and high-level, and it could take a very long time to get there, but that is what is emerging as the answer, in part in response to the challenge of business rate retention. Councils now have to think very much about how they are going to grow their way out of this problem while reducing demand for their services, so they can find that new equilibrium.

Q24 Alison Thewliss: I just want to say that that was a very interesting point about looking at a system of specific interventions by Government in areas that have not managed to grow or to break that cycle. From my own area, Clyde Gateway is a really good example of that, where it is local government and the Scottish Government working together to try to break that cycle to get specific pump-priming for regeneration and very much taking the people in the area with them. Other projects have tried that and failed. They have just thrown money at the problem, rather than actually looking at the structural reasons for why that area had not grown and had not changed over the years, whether it be investing in regenerating brownfield sites or producing buildings of a quality that would bring employers into the area as well, changing the perceptions of it. There are lots of things that can be done in a cleverer way, rather than just saying, "We are just going to leave you behind". I do not think that helps in the long term.

Simon Parker: In the past, the choice has been between being left behind or being subsidised. Most places want to pay their own way. The question becomes about having to find new ways to support those areas. There probably will not be that many of them, but they will be there and they will be a blight on British society if we do not address the problems they face. We are going to have to find new ways to invest in those places and to get them back on their own two feet economically, in some way.

David Phillips: To be fair to the UK Government, there is some thinking around that area as well. You can think of the City Deals in that light, where it is about local government and central Government coming up with a plan together about certain areas. Whether or not they will be successful, we do not know yet. There is also a question of

how many strings the money comes attached to. On the one hand, you might think the money is earmarked to specific areas to tackle these bottlenecks and problems. On the other hand, you might see all this money as potentially undermining local decision-making. Again, there is no simple answer to this. The more strings it comes with might make it more targeted, but the local area might want to spend that money on social care as opposed to building a new bridge.

Dr Muldoon-Smith: The pump-priming point you made was very good. Again, it is coming back to the point I made earlier on that, really, the only way you can grow business rates is, a lot of the time, building new property in a lot of areas. You simply cannot do that. They do not have the economic fundamentals. They do not have buoyant rental economies to justify construction, basically. If you imagine there is going to be a gap in viability, a very simple pump-priming grant would just be inserting an amount of money. Some research was done in Sheffield 10 or 15 years ago, which said that pretty much anywhere out of the core cities and the centre of London would always have a gap in viability for certain types of floor space. If you can fill that gap, that is where the pump-priming investment would almost come back in. That would not be a subsidy.

Alison Thewliss: It would be an investment.

Dr Muldoon-Smith: Yes, exactly.

David Phillips: Given we were talking just now about some peripheral areas that might lose out and the example of Knowsley in Liverpool, one thing that could be worth thinking about is, rather than business rates being retained at the very local level, some pooling at slightly larger regions, potentially city regions. What exists at the moment is the potential for districts to pool their business rates under the current system. Actually, the incentives that exist to pool under the current system are slightly distortionary. People are pooling not because they think they can do better in terms of generating growth by pooling, but because they can get around the system of levies and safety nets by pooling together.

Dr Muldoon-Smith: It is gaming the system, is it not?

David Phillips: It is gaming the system, exactly. In future, high-growth authorities such as Liverpool, whereas at the moment they might want to pool with Knowsley to game the system, so to speak, in future if these gameable bits are removed, will not want to pool anymore. It goes from there being some incentive to pool, albeit a distorted one, to one where there will not be. Maybe something to think about is whether this retention should not be at the very local level, but at a somewhat higher level, especially in city regions, where there are

these regional structures to make decisions about planning and development.

Q25 Chair: Can we move on to another important element of the reforms, which is that the system is deemed to give more money to local government than the current system? I think £13 billion has been mentioned as extra money in the system. Is that generally agreed as a figure?

David Phillips: No. £13 billion is about the amount of business rates that will be devolved. There is then about £2.5 billion of revenue support grant in 2019. In 2019-20, there will be £13 billion of business rates replacing £2.5 billion of revenue support grant, so that is £10.5 billion net transferred and then you need to think what additional things you transfer to use up that £10.5 billion of new money.

Q26 Chair: We are really looking at £10.5 billion. Will it have gone up by 2021?

David Phillips: It depends what happens to the revenue support grant. We do not know what the revenue support grant will be in 2020 yet. 2019 is the end of fiscal consolidation, so you might not think it would fall any further, but we do not know for sure.

Dr Muldoon-Smith: Is it really new money or is more money that was previously spent on other things, which is being redistributed?

David Phillips: It is not actually new. It is new money in the sense that it is money that is currently being funded by other specific grants or is outside of local government altogether. The short answer is that it is £10.5 billion, not £13 billion.

Q27 Chair: Does CLG accept that? £13 billion keeps being used as a figure.

David Phillips: I have seen that figure as well and it was used by the LGA in the past. What they are referring to there is the amount of business rates, as opposed to the net effect once you subtract, but it would be worth checking with them on that.

Dr Muldoon-Smith: It is the other 50%, as far as I can see it. If the stock of business rates in the country is £26 billion, local authorities have previously had £13 billion and they are now going to get the other £13 billion almost. You are right; they are not taking it off.

David Phillips: Then you have to take off the £2.5 billion of revenue support grant.

Q28 Chair: If we want to look at new responsibilities, we should be looking at new responsibilities to the tune of £10.5 billion.

David Phillips: That is what I think, yes.

Q29 Chair: In terms of what new responsibilities might be given to local government to mop up this £10.5 billion, the Government have already made some suggestions. One of the things that the LGA has said, and I think others have said, is that, given that businesses are going to be paying this money, should at least some of the new functions relate to business and economic development. Is that a good starting point?

Dr Muldoon-Smith: It certainly is, but only to an extent. It is not going back to the democratic deficit; it is more going back to the economic growth element in the business rate retention scheme. All we are really talking about at the minute, in the announcements, is giving responsibilities back down. If we are actually going to grow, we need to devolve some responsibilities that are associated with growth, so things like skills and transport, but also some of the powers that I was talking about earlier, things like varying the local tax rate for instance, so you can start growing the economy at the same time as actually localising more responsibilities.

David Phillips: My view on that is that it is worthwhile thinking about those areas of economic development policy that could be devolved. As I understand it, a substantial amount is already devolved in those areas, around the planning regime, for instance, and local economic development. Skills could be one area that was mentioned, with more funding for, say, adult skills and further education. There is also transport, although there is the issue of a lot of transport spending actually being capital-intensive with very big grants, when this is revenue spending we are talking about here. Whilst it can be a starting point, you would need to look beyond it to other areas to get up to that £10.5 billion figure.

Simon Parker: As you have probably gathered, I draw the notion of economic development quite broadly, because I think public services play a role in economic development. That is what gives you the human capital you need to grow cities. The skills budget should absolutely be in line. We know that skills could be better organised locally; there is lots of evidence on that and it is starting to happen in some areas, so we are devolving that. It is also increasingly not a very big budget, so you could probably do that.

I would be interested in areas around things like employability services, which is also a set of budgets that is shrinking and are key to getting people back into work. I am interested in that area. Parts of the

criminal justice system are very interesting. What has that got to do with growth? One of the things that can blight a young person's career is getting a criminal conviction while they are still young. We know that restorative justice programmes in places like Surrey have greatly reduced the incidence of young people being convicted, diverted them from the criminal system and saved the courts a lot of money. It strikes me that parts of the criminal justice system might also be in line.

The principle for us, right from the start, has been that, if you look at the list of things that the Government have put in as suggestions so far, things like TfL capital money and housing benefit administration are fairly pointless new burdens, which do not really do anything, apart from to allow George Osborne to snip budgets. If there are going to be new responsibilities, they should be useful ones that councils can use to drive growth. If we start from there, we will come up with some good ideas.

Q30 Chair: I have just got a note about what the Sheffield City Region has put in, and I did not influence this, I hasten to add. I think they might be quite useful pointers. One was preventing demand, in which you could include restorative justice, but also public health, spending on early years and those sorts of things. Tackling productivity and prosperity challenges are skills, apprenticeships and those sorts of things. The other one was the ability to vary local offices' entitlements. In other words, I suppose the local government has some control over what it does. Simon, on the issue you just mentioned there, if all the local authorities did was to administer attendance allowances and pay them out, they are really just administering a central Government system. It is not devolution in that sense, is it?

Simon Parker: It is not really. We saw something similar with council tax support, of course, with a budget that was cut and then devolved, but with a whole load of rules attached to it that meant that councils could not really do anything, apart from cut it for working age people. The principle must be that, if you are going to devolve something, particularly something that is so risky and demand-driven, you have to give councils the ability to manage that risk and that means deregulating and giving them more responsibility over how they administer that.

Q31 Chair: Governments are not going to want to fragment a national system on attendance allowances. It is a national system.

Simon Parker: It is at the moment. We would have said the same about council tax allowance 10 years ago, but you are right; it would seem like a very substantial benefit to have wide variation across the country.

David Phillips: I was going to add there that, as well as thinking about the relation of these new powers to economic growth, the other key factor to think about in terms of what to devolve is the likely path of demand for certain spending and how that links to the likely path of revenues, both nationally and locally. We can use the example of attendance allowance again. Even if local authorities had the power to reform the system quite substantially, the plan is not to make them just administer the system. The reason it has been suggested is because it seems to be integrated with social care. The Scottish Government, for instance, asked for an attendance allowance in the past and is getting it under the Smith Commission, because it sees it as being part of the social care package.

The risk, at the very local level, is that there are very different ageing trends across different local authorities in England. Some areas, largely more rural and coastal areas in particular, have older populations and populations that are going to age more rapidly. Spending on attendance allowance or the associated replacements for it is likely to go up quite a bit in those areas. On the other hand, business rates and council tax are those areas' revenues. You might think that, if you have lots of disabled older people in your area, you might have fewer businesses and have less employment in your area with which to generate those revenues. Thinking about whether the projections of spending match the projections for revenue is a very important thing.

Dr Muldoon-Smith: It will almost be a norm, will it not?

David Phillips: There may be good reasons to devolve attendance allowance because of its integration with social care. I am not an expert to judge that matter but, as an economist, I would be wary about the negative correlation between demand for spending on this and business rate revenues. That is a fundamental question because, unless you have the grants to stop those measures, you cannot do anything to address these risks.

Q32 Bob Blackman: We have some written evidence from you about the opportunities that will be there for local authorities to cut business rates. What sorts of authorities do you think will take the decision to reduce the business rate to attract business to their area?

Dr Muldoon-Smith: Those that have budget surplus to be able to almost shoulder the loss in income might, in the first instance. For me, very few authorities will be able to do it, because they already have their backs against the wall. They are already losing money; they cannot suddenly reduce it again. Yes, if they attracted businesses in that is great but, in many instances, they already receive empty property rates, so they would not actually be making any more in

business rates, if that makes sense. Yes, they might have indirect cash into the economy, which obviously has a secondary impact, but it would not actually make its way back into the business rate pool.

Q33 Bob Blackman: What is the impact? One of the things that is clear from the evidence is that there is a potential race to the bottom, with authorities competing with one another to try to attract businesses. The same businesses will just swap from one area to another to gain the advantage of the lower business rates. How practical is that? Most businesses cannot move if they have factories or are using particular buildings, and the cost of moving can be quite heavy as well.

David Phillips: I would say two things on that. First, on the fear of a race to the bottom and businesses having difficulties moving, yes, in the short term there are difficulties in moving but, over very long periods, when thinking about setting up a new branch or new location, or when your current factory becomes obsolete and you are looking at a new factory, these things can happen over longer-term horizons. If there were to be a race to the bottom, it might not happen overnight, but it could happen in the longer term.

However, I am not sure how worried I am about that. There is not much evidence about the extent to which this will happen, apart from the fact that local authorities have already had quite substantial powers to cut rates under the Localism Act 2011. These are quite complex powers to use. They are granting reliefs, not actually cutting the headline rate. In its initial impact assessment, DCLG said that one example of a relief you could make would be a relief for all businesses that is, in effect, a cut in the headline rate. As far as I am aware, no local authorities have done that. Only a few have done more targeted rate reductions.

The existing evidence is that they have not been using the powers that are there already, which are very similar to the new powers. Now, it could be because the old powers are labelled as "reliefs" and it is a more complicated process. This new simpler process and the nudge they are getting from Government to be more competitive could make them use the powers more, but they have not been using the powers that they already have that much so far. Maybe whilst there is a risk of a race to the bottom, it is not that great a risk.

Dr Muldoon-Smith: One other thing that might cause inter-authority competition is that there is still an incentive to build new property. If you continue to build new property without a concomitant increase in jobs, the value of the property is going to decrease and Business A is now going to be able to afford to go to Business B at a higher specification. You can imagine that certain authorities are going to be

able to build the property. They are going to be given incentives. Planning authorities can give certain different incentives. Fundamentally, Business A is going to be able to afford a lot more from their property than they did previously, because certain authorities are going to be able to build more property and the value of the property will reduce, so you will create a market of abundance almost, and then you will start seeing filtering and displacement between areas. We can only monitor that and see if it happens over a period of years. I do not see it happening because of the rate reduction.

Q34 Bob Blackman: Taking the points that you raised earlier, Simon, on Knowsley, if they came together as a Greater Merseyside consortium and then decided that, in order to drive business growth in Knowsley, they are going to reduce the business rates there, so it would be much more preferable for someone to come and invest there rather than another part of Merseyside, would that be a way forward?

Simon Parker: I suppose it could be. You would be moving investment around the Merseyside conurbation more. Very few people are going to decide to locate in Liverpool rather than Manchester, because of a marginal change in their business rate. Yes, it might be a way of directing economic activity to poorer parts of the conurbation.

Dr Muldoon-Smith: It would not necessarily filter into the business rate system, if we are trying to increase the amount of business rates that local authorities had to pay its services. They are already getting empty property rates at a higher level. If you then start attracting in businesses, if it was a smaller business, they would be paying business rates at a lower level.

Q35 Bob Blackman: One of the other problems that is faced, certainly in the South East and London, is that office blocks are now being converted to housing at low rates of income, because of council tax. Alternatively, buildings are literally being demolished and replaced by housing. I could take you to many parts of London where that is happening quite dramatically now, so the business rate income is falling for local authorities at the moment and, once the land has gone, the business rates have gone. They are not going to come back.

David Phillips: That is an interesting point because, under the old system, local authorities did relatively well when those conversions were made. They were not affected by the changes in business rate revenues, but they did get the council tax at least and the New Homes Bonus. Under the new system, they still get the council tax but, because that is not that strongly linked to property values, especially in London, they would receive relatively little from that. Business rates are much more strongly correlated to property value, so they would lose a

lot more in the business rates than they would get back in the extra council tax. You have gone from this system where councils had a bit of an incentive to get these conversions done, because they got some more money out of it, to one where they sometimes have a big incentive not to get it done, because they lose all their business rates and do not get enough council tax to compensate. Might you see some parts of the country pushing back more on these kinds of conversions now that the incentives have flipped around? Maybe you will.

Dr Muldoon-Smith: One other point on office to residential is that it has had a huge impact in London. We have done some research on PDR office to residential, and elsewhere in the country there is not as much going on, again because of the viability of actually converting the buildings. It is a massive issue in London, in terms of loss of stock.

Q36 Bob Blackman: Just to turn that on its head, the other issue is that, if we are getting a tremendous amount of competition between local authorities, are we going to see new businesses being set up on that basis? Should local authorities therefore be creating business premises where businesses can move in, either as start-ups or new businesses, to encourage business to come in? Do you see that happening as a result of these measures?

Simon Parker: I question the idea of whether we are going to see tax competition, red in tooth and claw. We have always said that we do not think it is very likely that many authorities would want to cut and, even if they did, would that have a huge impact on business decision making? As well as that, if this were a scheme that would go ahead on the basis of conurbations in particular, if this was Merseyside or Manchester, that would again in useful ways blunt the incentive for tax competition. It is very useful for Merseyside and Manchester to compete. I do not think it is very useful for Tameside and Manchester to compete.

Should we see local authorities building places to attract in businesses? Why not? Councils are starting to do this sort of thing to get involved in the development of office space and co-working space. I work in a co-working space just off Trafalgar Square. I believe that Westminster City Council owns part of the lease. Over the last five years, we have already seen a considerable stepping-up of local government's commercial nous and its ability to invest. If you went to a council like Essex, you would see a gigantic commercial plan going ahead to generate business rate income and a New Homes Bonus. The council has a very large balance sheet and it is able to do that, but of course it is on the capital side. On the revenue side it is very hard-pressed.

David Phillips: This is a very interesting issue for the Committee to look into because, again, it is an incentive that has changed completely with this new system. Under the old system, if a local authority wanted to invest its capital in property, it would get some rental income on it, but the business rates would all be redistributed around the country. It now has the rental income plus some of the business rates, and all the business rates under the new system, which might make it more of an attractive proposition for councils to invest in property. I am not sure what the legal restraints are, if there are any, but it could be a really interesting margin of response to see if that is likely to happen.

Dr Muldoon-Smith: It is not necessarily about councils investing their own capital. It is almost making areas more attractive to speculative office development, for instance, which is again where it goes to planning departments. They start greasing the wheels of the system a little. Coming back to your point, the fundamental issue is that, if we are creating new floor space, are we also creating new jobs? If we are not creating jobs at the same time, we are just building speculatively, and we have the risk that we are just going to start sucking jobs from elsewhere and moving them around.

David Phillips: If they are building these business spaces and they are remaining empty, the council is paying business rates to themselves. If they can get that space filled, the incentive is increased under the new system.

Q37 Kevin Hollinrake: Dr Muldoon-Smith, you referred to the empty business rates to which you proposed bringing reliefs back to in one of your submissions. You were saying that that is a disincentive for local authorities to cut business rates, because they are getting the rates anyway.

Dr Muldoon-Smith: The situation is perverse. I believe that the level of empty property rates should be reduced and then it is a local authority's best interest to fill those empty properties with businesses for economic growth. It is going back to the situation earlier on that you were talking about; the problem is that, if you get rid of that maximum empty property rate value, it puts local authorities at risk in a recession when businesses go out of business. If the reality of the policy is about economic growth and creating jobs, empty property rates will really have to go. It is a strange situation, is it not? Under business rate retention, we make more money out of vacant properties than we do out of offices filled with businesses, for instance.

Q38 Kevin Hollinrake: There are a couple of things there. As you know, lots of tenants find ways around this. There is an incentive to get a

proper occupier in there for starters. The other thing is that, aside from the ones that are already empty, you are also trying to attract somebody who is going to relocate. You might look at the North West. You might look at Liverpool or Manchester and decide. Hiscox has come to York, for example. If there is a concession in an area or a de facto enterprise zone, for example, is that not an opportunity for a local authority to attract people to their area, by providing a concession on business rates?

Dr Muldoon-Smith: You mean in terms of reducing it. We are not talking about empty property rates here. We are just talking about reducing the actual rates.

Kevin Hollinrake: The actual rates, yes.

Dr Muldoon-Smith: Yes, it is, and I certainly do not have an issue with that. All I am saying is that I am not really sure that a local authority will make any more money when the business moves in, strictly from the business rate retention point of view with money going into the coffers of a local authority. Are you talking about bringing a business from somewhere else into a vacant property, for instance?

Kevin Hollinrake: No, I am not. I am talking about going to an empty bit of land. Hiscox has come and built a 1,500-square-foot office building in my local authority area.

Dr Muldoon-Smith: That would be an incentive, yes.

Q39 Kevin Hollinrake: Is that not what this is all about really? It is not just about existing premises. It is about attracting new investment.

David Phillips: The main thing with this system is that it is about attracting new development, whether that is new buildings or refurbishment of existing buildings, because that is the only revenue they get to keep. The revenues from existing buildings are recycled around with these tariffs and top-ups, to a large extent.

I agree with what Kevin is saying in regards to the way the empty property rates work, but there is a flipside to that. It depends on who you think are the people holding back the occupation of empty properties. Under the system where you have long-term empty property relief, it might be in the interests of a landlord to keep it empty in the hope that they can get someone to come in and pay a high rent, rather than rent it out in the short term to get a lower rent. They have changed empty property relief and reduced it to stop the equivalent of land banking—empty property banking. If you make empty property relief more generous, you bring that risk back in more, on the flipside.

Q40 Mary Robinson: Looking at weighing up old systems and powers against new, the Chancellor announced that directly elected mayors working with LEPs would be able to add a premium on to business rates under the new structure. What can the infrastructure premium provide that the BID and business rate supplement mechanisms cannot?

Simon Parker: The obvious answer is scale. BIDs, by and large, are quite small and bounded geographically, which is one of the reasons why they are very democratic. It is possible to do that over a relatively small neighbourhood or a high street. Clearly a BID would not give you anything like the amount of money you would need to build a new bridge or a motorway, so the scale of a LEP for Greater Manchester or New Anglia gives you a size at which that 2% is worth quite a lot and can make a difference. That is the main thing.

Q41 Mary Robinson: It can be pooled across the combined local authority area and the LEP.

Simon Parker: My assumption is that, given it is the mayor who would be levying the 2%, the money would be spent by the combined authority on its infrastructure programme, as agreed with the LEP.

Dr Muldoon-Smith: In comparison to a BID, you lose a little bit of that democratic interest in the initial stage. I take the point that it is very difficult to do on such a big area but, if we are funding large-scale infrastructure projects, they have a habit of going over and taking a bit longer to finish. Then you end up with the issue of who voted for this in the first place. If you just went through a LEP, it might not even be there if it has been replaced by a different structure again, for instance. There are some good things in the BID in terms of getting that democratic accountability at the beginning.

David Phillips: If I can follow up, is there not already another addition to that? There are BIDs. There are these new infrastructure premiums to be levied by mayors, but there is already a potential to raise infrastructure levies, as was used for the Crossrail scheme. What is not clear to me is the relationship between these new powers for the mayors and the existing powers, introduced in 2010, which allowed the Crossrail funding scheme to work. Will these two powers work side by side? Actually, the existing powers that allowed Crossrail do not require elected mayors and LEPs. They look a lot more like the BID system if these are big infrastructure projects. What is not clear to me is if these old powers are being abolished when these new ones are being brought in and what that means for those areas that do not have mayors. They cannot use the new powers, and cannot use the old ones in principle. Are they going to be left with no powers for this?

Q42 Mary Robinson: Would the earn-back system also work within that structure?

David Phillips: Yes, that is another question. It is a question I have not thought about, but it is another issue.

Simon Parker: Earn-back would support that structure, in the sense that you are investing your infrastructure money, which presumably would then generate more back through an earn-back system, if you had one.

Q43 Mary Robinson: Looking at the democratic investment there, is the involvement of LEPs a democratic way to decide whether local businesses should help to fund these big infrastructure projects?

Dr Muldoon-Smith: It is difficult when you automatically say that, in comparison to a BID in a small area, you get everybody involved in the decision. With a LEP, it fundamentally is not. I take the point that it would be a more efficient, quicker way of making a decision.

David Phillips: I agree with that. It is a trade-off, because there is less direct accountability to the tax base, the taxpayers, than there would be under a BID, but it is actually more than when most taxes are changed. There is not a plebiscite every time the Chancellor changes the tax rate. It is on that scale. It is a trade-off between the most democratic ways. You want to aim for some democratic accountability, but for it also to be feasible and not tie your hands too much.

Simon Parker: If it is democratic, it is probably wrong. The mayor is the democratically elected person, they are taking the decision and they will be accountable to it for their electorate. The LEP is a check and balance, and it strikes me that it is quite a useful check and balance, because it means that the mayor cannot just put down anything they want. They cannot just do infrastructure projects in areas where they want votes, because the LEP will be there to check that what they are doing is in the interests of local businesspeople. Personally, I am not sure that many mayors will enjoy being told what to do by a bunch of unelected businesspeople, but checks and balances matter.

Q44 Mary Robinson: The choice would be against a ballot of the business community, would it not? I suppose that is the counter to it.

Simon Parker: That seems like a tremendous amount of work. It will not be gigantic sums of money, year in, year out. As David rightly says, the level of accountability we are putting on this and other local public taxes, compared to what the Chancellor routinely does without asking one, is absolutely astonishing.

Q45 Mary Robinson: Aside from raising the multiplier then, are there any other powers that would enable councils to maximise the growth in their business rates?

Dr Muldoon-Smith: Instead of additional powers, it is almost improving the existing system. For instance, on the point I made at the beginning, it is dealing with the historical rateable value appeal system. For a lot of authorities, as I have already said, the value of these appeals more than outweighs any growth that that authority can make. We need to try to remove that from the system, one way or another. One way to do that could be for a local authority to retain all of its growth, but the value of appeals could be averaged out across the country. You pointed out empty property rate avoidance. That could certainly be targeted, because it is all about maximising business rates. There are an awful lot of sham businesses out there that are helping landlords avoid paying tax, so I would think it is about maximising the current yield, rather than looking at new powers, I guess.

David Phillips: I am not sure this is a power that should be devolved to local authorities or that it is a reform that should be made to business rates more generally. One of the complaints made about business rates is that they discourage investment in property, plant and machinery. The solution to that as a whole is to impose land value taxation, which I will not bang on about that today, but one way that you might think about boosting growth incentives in an area is potentially to adjust the business rates tax base so it does not cover plant and machinery, at least, even if it covers property. You might think that the plant and machinery investment is more sensitive to the taxes than the property investment is.

The reason I think that is because, ultimately, a lot of the burden of the business rate does not fall on the occupier. It falls on the landlord in terms of the lower rent they get than they would if the business rate did not exist. That is because business rates are levied across the entire country, so affect every property in the country. In those circumstances, they tend to fall on the landlord. If you are buying plant and machinery imported from Germany, they are not going to sell that to you for less because you are paying business rates on that, because they can sell anywhere in the world. That would be more prone to being discouraged by business rates, because you cannot get a price reduction to offset the business rate. Maybe one way to get more growth would be to remove some plant and machinery from the business rates. That will encourage growth. Of course, you are losing some revenue. If you need to, you can make that up by having a slightly higher tax on earning properties. There would be a trade-off

there: you are making some people worse off to make others better off, but that would be better for growth.

Q46 Chair: Can I just ask one point about the LEPs? The proposals from the Chancellor seem to assume that the mayoral area and the LEP are the same. Now, in some places, they will not be the same geographically, so you could have the very odd situation of a substantial democratic deficit where LEP board members are effectively voting for a tax increase in another area than the one that their business is in. That is going to be a problem with this, is it not, which does not seem to have been thought through?

Simon Parker: We will have to add that to the very long list of geographic problems that devolution is causing in the country.

David Phillips: It is an ad hoc process that devolution is causing.

Q47 Kevin Hollinrake: I meant to ask in the previous section if you would make small business rates relief permanent.

David Phillips: Economically, there is no strong rationale for small business rates relief. If you think that, actually, in the long run, most of the business rates are capitalised in the value of a property and the value of the rent, it is not small business rates relief; it is relief for landlords of small businesses. I am not sure the economic rationale is that strong. If you were going to have it and keep extending it, year after year after year, then maybe for tax policymaking reasons, it is worth saying that this is our permanent intention, rather than saying it is as a rabbit that can be pulled out of a hat multiple times. I am not sure whether any measure has managed that trick before.

Q48 Chair: I have just one final thing. We often get lobbied by smaller shops in the high street, saying, "Our burden is unfair". Is there any easy way of rebalancing that so that out-of-town shopping centres pay more than in the current system, so you actually rebalance what businesses pay from the out-of-town centres paying more to the small high street shop paying less?

David Phillips: My answer to that would be that I am not sure that I would use the business rate systems to fix that. If you think they have more fundamental problems with the environment facing small versus large businesses, I would try to address that with bespoke solutions to those, rather than changing a system that is fundamentally about levying a tax on property equally across different property types to raise money for government services. I again come back to at that point that, if you think this is mostly being capitalised in rents, it would be a lower rate for the small business landlords, rather than the small

businesses themselves. I am not sure you would deal with the problem. You would be paying more to the landlords and less to the council, in that world.

Dr Muldoon-Smith: It is standardising business rates, so that different types of property or property sectors operate completely differently. I do not think we always manage that situation. Retail has its own issues; industrial has its own issues; office has its own issues. The lower rate of tax needs to be a bit more flexible, so you can start working with different segments of property.

Chair: Thank you all very much indeed for that very interesting evidence you have given us this afternoon.