Communities and Local Government Committee

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Contacts
All correspondence should be addressed to the Clerk of the Communities and Local Government Committee, House of Commons, 7 Millbank, London SW1P 3JA. The telephone number for general enquiries is 020 7219 1353; the Committee’s email address is clgcom@parliament.uk
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Summary

The recent Green Paper, *The Governance of Britain*, contemplates “enabling local communities to take decisions about how to use local funds” and ensuring “that local priorities are being met”. We believe that Sir Michael Lyons’ proposal to allow local authorities to make marginal changes to the national non-domestic rate which businesses pay as their contribution to the provision of local services is entirely consistent with and an attractive step towards achieving this objective.

The Government offered, in both the March 2007 Budget and its more recently published *Sub-national review of economic development and regeneration*, an encouraging but general reaction, promising to give the matter further consideration and to make a more substantive response later this year. That response should, we argue, set in motion a process to enable local authorities, including upper and second-tier authorities in two-tier areas, to levy a supplementary business rate to increase or decrease the business rate paid by local businesses. While the majority of decision-making on the precise nature and purposes of individual levies should be left to the discretion of local communities, the Government should set basic parameters to define the operation of supplementary business rates and confine the purposes to which any revenue generated might be applied. These parameters should include requirements that

- local authorities secure the agreement of the local business community not only to introduce a supplementary business rate but also on the purposes to which revenue may be applied;
- where proposals for a local supplementary business rate contemplate a variation from the national business rate of more than 10 per cent, a ballot of the business community affected should be the norm;
- revenue from a supplementary business rate is spent only on genuinely additional projects deemed to benefit the local business environment and cannot be used to meet existing spending commitments on the part of local authorities;
- the rate, duration and purposes of each supplementary business rate should be clearly defined the outset;
- local authorities remain liable for any supplementary business rate operating in an area in which they occupy buildings, and
- where a supplementary business rate is introduced in an area where there is already a business improvement district, there should be an off-set for BID contributors against their supplementary business rates liability.

We recognise that the option of raising local funds for local investment through a supplementary business rate may be most attractive in highly urbanised areas. The Government should consider further options which would be more suitable in other areas. Such reforms to local government revenue should be regarded as a first step rather than the last word in a development process of financial devolution.
1 Introduction

1. Sir Michael Lyons’s report on local government envisaged local authorities as ‘strategic place-shapers’,—building and shaping local identity and cohesiveness and fostering economic development as well as providing services and regulating behaviour—but he identified a number of factors which he considered constrain their capacity to perform this role fully.\(^1\) Chief among these are:

- the high degree of control exercised by central government, driven by sophisticated performance management, a burdensome weight of targets and indicators, and an increasing tendency on the part of central government to take responsibility directly for specific issues;

- little local flexibility over the deployment of existing resources, compounded by a tendency for an increasing proportion of local government revenue to come from central government as ring-fenced grants or monies otherwise tied to specific purposes, and

- limited capacity to raise additional revenue locally.

2. We share these views on the constraints limiting local government’s effectiveness. We welcome Sir Michael’s report and the emphasis it places on rebalancing financial arrangements as part of the mix of progressive reforms required to renew and empower local government, enabling it to engage more fully with local communities, including businesses, and better to reflect and shape localities.

Local government finance: the status quo

3. Local authorities derive income to fund their activities from four main sources:

- local residents via the council tax;

- local businesses via the uniform business rate (UBR) which is also known as the national non-domestic rate (NNDR);

- central government grant, and

- a variety of fees and charges.

The contribution made by central Government to local government is in the form of ‘formula grant’ and other grants that may or may not be tied to specific purposes. Formula grant is made up of three elements—NNDR income, revenue support grant (RSG) and police grant. Collectively formula grant and specific grants are termed Aggregate External Finance (AEF). In addition to AEF, central Government makes other special grant payments to local authorities, usually referred to as special grants outside AEF, some of which are related to mandatory payments such as rent allowance payments. Others may be

targeted but without restrictions. In 2006-07, central government financed 76 per cent of local government’s gross revenue expenditure.2

4. Since the mid-1970s the RSG has been what is usually known as an ‘equalising grant’. This means that it has been distributed between local authorities in such a way as to take account of differences in their spending needs, as assessed by central government, and their ability to raise money from local tax. In theory, if each local authority were to spend at the level assessed by central government each local authority of the same type—e.g. all district councils—would be able to set the same rate of council tax. Although local authorities and others have often questioned the reliability of successive governments’ methodology for measuring spending need, there has been broad agreement over the merits of having an equalising grant system.

5. Currently householders’ liability for local taxation is based upon the broad capital value of their property while businesses’ liability depends on the rental, or rateable, value of the premises they occupy. Although the tradition of property taxation in Britain dates back several centuries, local authorities’ powers to levy local taxes largely date from the nineteenth century. Initially liability for a local ’rate’ was aligned to the right to vote, a right that was itself often determined on the basis of property ownership or occupation. Thus both businesses and residents became ratepayers. Debate over the basis of local taxation, and aspects of its impact, has existed from the start. Politicians from across the political spectrum, from the nineteenth century Conservative Prime Minister Lord Salisbury to the radical thinker Sydney Webb to former Labour leader George Lansbury who, as Mayor of Poplar in 1921, led his local borough council in refusing to forward the tax revenue it had collected, have questioned the size of rate demands and the effect on individuals.

6. Local authority services have been subsidised from central sources for more than a hundred years. In the wake of the Second World War, local authorities played a significant role in the development of the welfare state, with services such as education, housing and social services being delivered, and paid for, at the local level. Although the support given to local authorities by central Government increased significantly to meet these new demands, local rates increased in real terms. In the 1960s, the ‘domestic element’, a small subsidy from central Government, was introduced to reduce the rate of increase in householders’ bills relative to other ratepayers but this did not compensate fully for the combined effects of the high inflation in the early 1970s and the costs involved in the provision of an increasing range of local services. Local taxation was consequently forced up to levels far higher than previously. In 1974, the average annual increase in local rates for all ratepayers—businesses and householders alike—exceeded 30 per cent.3

7. Such huge rate rises provoked widespread dissatisfaction and, in response, the Government appointed (later Sir) Frank Layfield QC to lead the first of what was to become many modern inquiries into local government finance. Reporting in 1976, the Layfield Committee put forward two models for future funding. The first effectively put central Government in control of local government finance. The second option, favoured

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by a majority of the Committee, envisaged much greater local autonomy and the introduction of a new source of local revenue. In the event, neither proposal was implemented and no reform of local taxation took place.

8. The post-1979 Conservative Government contemplated significant reform, publishing a Green Paper in 1981, which considered a range of alternatives to the domestic rates, including a local income tax, local sales taxes and a poll tax. Again, no reform followed. A further Green Paper in 1986 revived the idea of a poll tax, now termed ‘community charge’. The latter replaced domestic rates in Scotland in 1989 and in England and Wales a year later. At the same time direct central control over the revenue raised from business was imposed and the NNDR became a nationally determined ‘assigned revenue’. The community charge proved unworkable and short-lived: in 1991, the Government reduced liability by £140 per head and simultaneously increased the rate of Value Added Tax from 15 to 17.5 per cent to compensate. A further review of local government revenue resulted in the replacement of the community charge with council tax two years later. The NNDR remains in place.

9. In January 2003 a further review of local government finance was launched by the then Local Government Minister Rt hon. Nick Raynsford MP, this time focusing on balance of funding issues specifically. It reported in July 2004. Shortly beforehand our own predecessor committee had reported on Local Government Revenue, calling for a re-localisation of the business rate and a severing of the link between increases in the business rate and the Retail Price Index (RPI). At the same time, the Government asked Sir Michael Lyons, Director of the Institute of Local Government and Professor of Public Policy at the University Birmingham and a former chief executive of three major local authorities, to undertake an independent review of local government finance. His remit and timescale were extended in 2005 to include the role and function of local government. Sir Michael’s final report, Place-shaping: a shared ambition for the future of local government, was published alongside the Budget in March 2007.

10. Like Sir Michael, we have found that many are under the misapprehension that before 1990 local authorities were free to reduce the burden of taxation on residents at the expense of business ratepayers. This was never the case. Before the abolition of the domestic rate and the ‘nationalisation’ of the business rate in 1990, businesses and householders in principle paid the same local tax at a rate set by the local authority. Indeed, as Sir Michael Lyons notes, “business and domestic rates were actually aspects of the same tax.” In practice the ‘domestic element’ reduced the tax rate for householders by 18p in the pound.

11. Following the 1990 transfer of the non-domestic rate to central government and £140 reduction in the community charge in 1991, the proportion of local authority resources raised from local taxation fell to 20 per cent. Although this has since increased slightly there is still a significant gearing problem for local authorities: each one per cent increase in expenditure leads to a council tax increase of some four to five per cent. Over time successive Governments have encouraged local authority expenditure to rise more steeply than the central funding supporting that expenditure, meaning that the revenue required

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5 Lyons report, para 8.6
from council tax, that is from householders, has risen far more sharply than spending. At the same time increases to the NNDR have been capped by a statutory linkage to the RPI, so the contribution made by business has remained constant in real terms even though it has declined as a proportion of overall local authority revenue.

12. The business rate is chargeable on all non-domestic properties barring certain reliefs and a total exemption for agricultural land or buildings dating from 1929. Although collected by local government (district authorities in two-tier areas), a uniform national rate is determined by central Government. Between 1990-91 and 2006-07, business rate receipts were paid into a national pool and redistributed by central Government to local authorities as a flat-rate grant according to the number of people resident in an area and, from the introduction of council tax in 1993, also taking into account the range of functions undertaken by the local authority (different arrangements apply in the City of London).

13. In 2006-07 the Government made a number of changes to the grant distribution arrangements including removing schools funding from the RSG and introducing a new, ring-fenced Dedicated Schools Grant (DSG), new needs formulae and a new block grant distribution mechanism. Most of the funding for the DSG came from the RSG. The amount remaining for distribution fell from £26.7 billion in 2005-06 to just £3.4 billion for 2006-07, increasing the proportion of central government funding for local authorities which is ring-fenced for specific purposes or targeted from five per cent to 53 per cent (54 per cent in 2007-08). Having taken this decision, the Government was forced to use income from the NNDR to equalise between local authorities in terms of needs and resources purposes as there was insufficient RSG remaining within the formula grant pot. Indeed NNDR income has become essential to the equalisation process. Another consequence of ring-fencing schools funding is that the gearing ratio has been changed.

Our inquiry

14. Reforming the way in which local government is funded is an urgent necessity if local authorities are to continue to fulfil their duties to local residents, to take on the place-shaping role set out by Sir Michael Lyons and to exploit fully, to the benefit of the communities they serve, the devolutionary approach set out by the Government in the local government White Paper, *Stronger and Prosperous Communities.* Current funding arrangements, dominated by the will of central government, inhibit such aspirations. We are conscious that, despite the sterling work done in the series of reviews which have taken place over the last 30 or so years, little has been done to affect strategic, as opposed to reactive, reform of local government finance in the round. Wishing to avoid any possibility of causing a further delay in Government action, we have conducted a short and pointed inquiry into Sir Michael’s most significant proposal relating to local government finance—the suggestion that local authorities be given the power to raise a local supplement to the NNDR. We have also examined concurrently and on a similar timescale proposals to alleviate problems within the council tax benefit system. A separate report is in preparation. The urgency with which we have undertaken this work signifies the

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6 House of Commons Standard Note: Local Government Finance Settlement 2007-08, January 2007, p. 3
7 Department for Communities and Local Government, *Stronger and Prosperous Communities*, October 2006, Cm 6939
importance we attach to these matters and our belief that persistent procrastination by successive Governments over devolutionary reform, demonstrated by the long history from Layfield onwards of ineffectual reviews never fully implemented, is damaging both to communities and to local government and is contrary to the principles of fair and good governance. We started our inquiry in May 2007, just 11 weeks ago.

15. We have built upon, rather than duplicated, the work undertaken by those who have examined local government finance over the years. In this respect we owe a debt of gratitude not only to Sir Michael Lyons and his team for their expertise, for their interesting proposals, and for their willingness to share the fruits of their labour with us, but also to those who contributed to earlier reviews. We are particularly grateful to those individuals and organisations who contributed to our inquiry directly through written submissions or by answering our questions in person. We would also like to extend our thanks to our specialist advisers for this inquiry, Rita Hale OBE, former Director of Rita Hale & Associates Ltd and a local government finance consultant, and Professor Tony Travers, Director of the Greater London Group at the London School of Economics, for their guidance, insight, and willingness to work to our demanding schedule.

16. We regret that, despite the series of reviews of local government finance that have taken place over the last 30 years, from the Layfield Committee onwards, there has under successive Governments been little change designed to create a funding system that supports and enables local authorities to fulfil their role as ‘strategic place-shapers’. We agree with Sir Michael Lyons that reforming local government finance is a key component in empowering local authorities. There is no excuse for the Government to squander the opportunity to develop an agenda for change alongside its response to the Lyons report, its implementation of the 2006 Local Government White Paper and reforms contemplated in the recent Green Paper, Governance of Britain.
2 Supplementary business rate

17. Businesses, as occupiers of properties, have long made a significant contribution through local rates and levies to the provision of services for the communities in which they are situated. In real terms that contribution has remained constant since the business rate was ‘nationalised’ in 1990-91 but in proportional terms it has decreased from 29 per cent of local government revenue to around 20 per cent in 2006-07.8 The changes in the proportions of spending financed by council tax and business rate payers is reflected in changes in the tax rates: since 1993-94 Band D council tax has risen by 132.2 per cent whereas the effective NNDR, after adjusting for the effects of revaluation, has risen by only 41.3 per cent.

18. Some have called for this trend to be reversed and for business to make a greater proportional contribution to local resources. East Sussex County Council, for instance, told the Lyons inquiry that “the current arrangements for the increase in business rates [… ] should have been more in line with the Government’s own planned increases in council tax, thereby sharing the proceeds and burden of growth”.9 Analysis presented to our predecessor committee by the New Policy Institute suggested that had the business rate gone up in line with council tax since 1990, as it would have done under previous arrangements, council tax rises for domestic ratepayers in the period would have been reduced by as much as a third.10 Similarly, Local Government Association calculations have shown that if business contributed the same proportion of local government revenue as it did even in 1997-98, annual council tax bills could now be lower by some £250 per household.11

19. Yet adjusting the balance of the burden of taxation between householders and business, or indeed the balance of funding between central and local sources, is not an end in itself. Our concern is to provide a funding foundation which positions and enables local government to do its job, spreads fairly the burden of taxation between tax payers and ensures the provision of good-quality services and robust regulation which match the needs of local residents and businesses.

20. Alongside discussion of the decline in proportion of local government expenditure met by the business rate we must set two other facts. Non-domestic rates remain a significant tax for business. The NNDR is expected to have raised £18.4 billion in England in 2006-07. Sir Michael cites research suggesting that for most businesses, the NNDR accounts for around three per cent of turnover.12 We were also urged, by the CBI and others, to consider the proposals for an SBR in the context of the overall burden of taxation upon business.13

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8 Lyons report, para 8.8
9 Lyons report, para 8.21
11 Memorandum from Canterbury City Council, SBR 11, para 1
12 Lyons report, para 8.10
13 Memorandum from the Confederation of British Industry, SBR 42, para 4
Lyons’s proposal for a supplementary business rate

21. Although in principle Sir Michael was sympathetic to those who favoured re-localisation of the business rate, he concluded that it would be technically difficult and that the time was not right for “such a substantial change”. He nevertheless argued that local communities “need more power to choose to raise new local revenues to invest in themselves” and that “Businesses have identified a need to invest more in the infrastructure needed to support future growth […] and an appetite for greater engagement with local authorities on economic development, including a willingness to discuss how the revenues for investment might be found”. His solution to this dilemma was to propose, among other measures, a locally determined supplementary business rate (SBR) as “the most sensible way forward.” Enabling local authorities to levy locally determined marginal supplements to the NNDR, he argued, would provide some flexibility, albeit limited, to raise additional revenues while having a limited impact only on business. Four key principles underlie Lyons’s proposal for an SBR:

The supplement should be:

• Local, both in the decision to levy a supplement and in the decisions about how it is to be spent;

• Additional, with any new revenues available to spend on new infrastructure or projects rather than taken into account in central government grant allocations;

• Transparent, so that business and other local taxpayers understand how much money is being raised and what it is being spent on; and

• Agreed with the local community, with the local business community having a strong voice in the final decision on whether there should be a supplement, and the purpose to which the proceeds are put.

In its March 2007 Budget report the Government gave a broad but cautious welcome to the proposals, stating that “a local supplement has the potential to support local economic development” but noted that certain protections and safeguards would be required. It undertook to give Sir Michael’s proposals further consideration—a process which it confirmed as underway its review of sub-national economic development and regeneration, published in July 2007.

14 Lyons report, para 8.38
15 Lyons report, para 8.26
16 Lyons report, para 8.41
17 Lyons report, para 8.40
18 Lyons report, para 8.45
19 Budget 2007: Building Britain’s long-term future: Prosperity and fairness for families (hereafter, Budget report, 2007), para 3.138
The case for SBR

22. SBR potentially offers a number of benefits to local government, to the business community and to the council tax payer. Sir Michael indicated that SBR was “intended to contribute to greater flexibility for local communities—residents, businesses and their representatives—to invest in themselves and in the future”. Investment of SBR revenue in projects which support economic development and thereby build up local rateable values of commercial and industrial property and broaden the business tax base in an area would in the long term spread the local taxation burden among a larger group of council tax and ratepayers, potentially reducing the liability of each individually and at the same time creating a more favourable business environment.

23. Several of our witnesses regretted the “disengagement” between local businesses and local authorities which had occurred following the introduction of the NNDR and argued that an SBR presented an opportunity to start to redress this. Canterbury City Council told us that an SBR could ensure that “the wider businesses community becomes more engaged with the well-being of the area”. Simon Wiles, Director of Resources for City of York Council, told us that an SBR “would draw the whole of the business in the City together.”

24. Three primary arguments in favour of SBR emerge from these considerations. It offers the potential for:

- genuinely additional revenue for investment in local projects and services which may increase the local tax base in the long term but which would otherwise be unfunded;

- a means of facilitating stronger relationships between the local business and local government communities, in particular engaging business more closely in mutually beneficial local regeneration and economic development, and

- greater flexibility for local authorities, allowing them to move towards adopting a stronger role in place-shaping and identity-building through tailoring both the revenue raising and investment sides of any SBR to local circumstances and local needs more closely than central government could ever do.

Each of these is individually persuasive but in combination they become a powerfully compelling case supporting the principle of an SBR.

The case against

25. Rather than demurring from these broad objectives, those who argued against the proposal tended to do so on the grounds either that an SBR was unlikely to achieve them or that practical difficulties in implementation would render the proposal unworkable or

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21 Lyons report, para 8.46
22 See, for example, Memorandum from Canterbury City Council, SBR 11, para 1
23 Memorandum from Canterbury City Council, SBR 11, para 2
24 Q 75
prohibitively inefficient, and often both. Kent County Council, for instance, argued strongly that an SBR would perhaps be counter-productive in terms of fostering good relations and was certainly too modest a measure to affect the degree of fundamental change required and that broader, more radical thinking was necessary to empower local authorities to work with their business communities to foster regeneration and economic growth effectively. It told us the debate should be about how non-domestic rating currently works and how that should be reformed, rebalanced and modernised as a cohesive whole. This should not simply be a question of how local government is funded, but how economic development and regeneration is best served through a dynamic relationship with business [...] the rationale for a top up supplementary rate is limited.  

Others focused on more practical considerations, identifying difficulties in making an SBR work effectively.

**Making SBR work**

26. Sir Michael concluded that if an SBR was to work effectively “both local authorities and local businesses will need to work hard to establish constructive and effective relationships, and to build trust and mutual understanding and respect”. Although this position was not contested by our witnesses several voiced disquiet over the practicalities of achieving sufficient confidence within the business community.

27. Many businesses are concerned that SBR could be seen by local authorities as a means of meeting current expenditure commitments rather than investing in genuinely additional projects and schemes specifically linked to economic development. The Federation of Small Businesses, for example, said it had “concerns that [SBR] could be used as an easy way to raise extra revenue for local authorities”. Given existing pressures on local authority budgets, which many local authorities vividly demonstrated during the course of our inquiry, such a reaction is understandable. Indeed, in 2001 the Government, following consultation, rejected earlier proposals allowing marginal local changes to the NNDR on the grounds that it had become “clear from many of the local authority responses that the supplementary rate was seen primarily as a means of raising revenue”. Nevertheless these concerns could be mitigated by a requirement that all revenues will be spent only for purposes stipulated in the initial proposal to levy an SBR, thus allowing businesses and local authorities to establish at the outset mutually agreeable purposes. **We recommend a statutory requirement be imposed that SBR revenues are ring-fenced. The purposes to which SBR revenues can be applied should be restricted by statute to those specific projects and schemes deemed by the local authority and the business**
community to benefit the local business environment and identified in the initial proposals for the levy.

28. Sir Michael rehearsed two further specific concerns commonly voiced by the business community. First, he noted those “about the implications […] of greater local discretion over tax rates”. These were reflected in some of our evidence too. Comprehensive performance assessments results however show that overall local government performance continues to improve. As Rt hon. Hazel Blears, Secretary of State for Communities and Local Government, said in a speech earlier this month, the most recent results of the Audit Commission’s assessments of local government show “outstanding results” and “nearly four in five [councils] were rated in the top two categories. And these improvements have also helped councils realise some £3bn of efficiency gains, meaning much better value for the taxpayer”. Greater local discretion over local taxation need not be seen as a threat as much as an opportunity to increase local accountability and distinctiveness.

29. Secondly some are concerned that variable business rates would lead to additional complexity and therefore impose an additional burden upon business. The majority of businesses, however, operate from a single property and therefore would need to understand only one SBR. Billing authorities (district or unitary councils) would continue to calculate liability for businesses. We do not believe that any on-going additional burden would be significant for most businesses.

30. The CBI told us that its members benefited from the “the certainty that the UBR provides”. Similarly the Rating Surveyors’ Association told us: “Of increasing importance over the last few years […] has been the linkage of the UBR to the Retail Price Index […] This has brought certainty, stability and predictability”. We are not deaf to businesses’ desire for certainty. It is a valuable commodity for business and the UBR has provided that for the last 15 years. But that certainty has arisen from the RPI cap rather than from the fact that the rate has been set at a national level: were it not for the statutory cap, central Government would be as free to vary the business rate and to do so to a greater extent than any local authority could have done under the former local arrangements where any increase in the business rate would have involved a similar increase for domestic ratepayers. SBRs, if introduced as we suggest with the rate stipulated by the appropriate local authority at the outset and lasting for a fixed period, offer much the same degree of certainty. Dermot Finch, Director of the Centre for Cities, argued that an SBR also provides additional certainty albeit of a different kind: “certainty to business […] that revenues are not being frittered away on a range of different projects” but invested to “help the local economy and […] help generally uplift the quality and the productivity of the local economy”. Certainty of this sort has value too.

Lyons report, para 8.34
Speech by Rt hon. Hazel Blears MP, Secretary of State for Communities and Local Government, to the Local Government Association Conference, July 2007 (http://www.communities.gov.uk)
Lyons report, para 8.34
Q 42
Memorandum from the Rating Surveyors’ Association, SBR 07
Q 80
31. Several witnesses questioned whether SBR, either on its own or as part of a combined package of measures, would achieve the desired relationship between business and local government. Key to resolving this issue will be the mechanisms employed to secure business agreement to specific SBR proposals.

**A ‘strong voice’ for business: consultation or ballot?**

32. We heard a number of arguments in favour of a mandatory ballot among the business community to secure agreement on levying an SBR in particular areas and on spending priorities for the revenue generated. A similar process, known as ‘dual key’ voting has been employed successfully in the establishment of Business Improvement Districts (BIDs), in which proposals for a local levy on businesses proceed only if the majority of the business community, in terms of both number and rateable value, is in favour. Indeed, the experience with BIDs has demonstrated that the requirement for a ballot has done much to alleviate businesses’ concerns over the concept of making an additional contribution to the provision of specific local services. The CBI told us that “Business feedback on BIDs has been very largely positive because they feel they have had a say in the process. Even where they had voted against a particular proposal which subsequently went ahead (because a majority was in favour), they were supportive because of the role they had played”.

33. We agree that a ballot would ensure that no SBR was implemented without adequate business confidence and recognise that in some circumstances it may be appropriate. Nevertheless, an SBR is only a marginal variation on a well established, well understood and broadly accepted tax and we can see no compelling reason why it should become the only tax in the UK upon which a specific ballot of those expected to pay is required. As Sir Michael noted “it would not be consistent with the accountability arrangements for other taxes, including council tax and other, national, business taxes”. Nor is business united in demanding a ballot on every occasion. The Federation of Small Businesses, while broadly opposed to SBR in principle argued that, should it be introduced, “there must be meaningful consultation with all businesses” and that “designated projects should have the backing and support of the business community” but it stopped short of calling for a ballot in every instance.

34. There are also practical considerations. Where widespread consensus can be secured through consultation, which may be the case in respect of modest proposals in particular, the costs and complexities of holding a ballot may be unjustified. Established forums for partnership working between businesses and local authorities, such as Local Strategic Partnerships, may represent one avenue by which such consensus could be reached. Ballots to renew a mandate for an existing SBR may be superfluous in the face of general

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36 Q 18
37 Memorandum from the Confederation of British Industry, SBR 42, para 7
38 Memorandum from the British Chambers of Commerce, SBR 09, paras 2.1 and 3
39 Lyons report, para 8.55
40 Memorandum from the Federation of Small Businesses, SBR 06, para 7.1
support for continuation, even for those SBR levies which were approved by ballot before being introduced.

35. Local businesses’ acceptance of levy proposals and spending plans, secured through a ballot or demonstrated through consensus-building consultation, should be achieved before any SBR is imposed. Sir Michael Lyons’s recommendation was that there should be no requirement for a ballot on SBR proposals within the affected business community. We agree. Local Authorities should, however, remain free to hold a ballot when local or specific circumstances warrant.

**Value for money**

36. The British Chambers of Commerce told us that there was “a persistent issue about value for money from the NNDR. Businesses do not receive good quality basic services from the rates that they currently pay”. The Institute of Value Management went further, suggesting improving value for money should come before changes in funding arrangements. For some local authorities, where the amount they collect in business rates is, because of the effects of equalisation, greater than the amount they receive from central government, issues regarding perceptions of value for money may be particularly acute. Dartford District Council explained its difficulty thus:

> The council collects a huge amount of business rates and the area receives very little of it back […] Dartford actually collected £63 million in business rates last year but the only amount that came back via the district, the county, the police and fire, was £20 million. £40 million of it has gone elsewhere […] it would be impossible […] to ask businesses to pay any more when two-thirds at least is going to other parts of the country.

37. As the Centre for Cities argued, however, SBR is a means of increasing local autonomy and local accountability and “criticisms of the existing systems, flawed though they may be, should not stand in the way of taking this first incremental step”. Moreover, support from the business community, whether secured through a ballot or through consultation, would be the foundation stone for any local proposal to levy an SBR. Few businesses would be likely to support levying an SBR in their area unless satisfied that the revenue would be deployed effectively. SBRs, then, could become an avenue for local businesses to pressure a local authority to improve its performance in terms of value for money: those who do not perform well in terms of value for money are unlikely to secure the required support from business to levy an SBR in the first place.

38. If we are genuinely to empower local government, to follow the course of devolution and community leadership, we have to accept the corollary: that nationally imposed policies and practices will rarely be appropriate and that local authorities, in developing

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41 Memorandum from the British Chambers of Commerce, SBR 09, para 2.4
42 Memorandum from the Institute of Value Management, SBR 02
43 Q 76
44 Q 79
policies and solutions finely tuned to local circumstances and local aspirations, will follow different paths.

**Will it work everywhere?**

39. In densely urbanised areas, administered by unitary authorities, where the business tax base is high and where there are frequently many businesses occupying properties with significant rateable values among whom to share the burden, and where a consensus on priorities for investment is more likely to emerge easily, the appealing prospect of generating significant investment funds for local priorities can easily outweigh any theoretical disadvantages or practical difficulties associated with an SBR. SBR is likely to affect different areas in different ways, depending on local economic conditions, geographical characteristics and political structures. Local authorities covering predominantly less developed areas may find that, because of comparatively low business tax bases, the advantages to be gained from even the most judicious investment of any revenue generated by an SBR may not justify the combination of additional administrative costs for the public sector and an additional demand upon the resources of local businesses involved. Centre for Cities, which is in principle supportive of the SBR proposal, told us that it was “definitely more suited to urban areas […] It is admittedly less useful for towns with a small basis, with rural areas for example […] we have to be very clear that SBR will have a differential impact. It is more suited to some areas than others.” We agree but we do not see this as a compelling argument against the introduction of SBR powers for all local authorities. Allowing, encouraging even, distinctive approaches among local authorities, enabling them to adopt policies and practices which are closely tailored to local circumstances necessarily involves diversity. As Dermot Finch, Director of the Centre for Cities said, differences are “part and parcel of the whole devolution agenda”. The facility to levy a supplementary business rate is most attractive for unitary authorities covering urbanised metropolitan areas. We are concerned that other areas, particularly less urbanised and rural parts of the country, would not be able to benefit or not to the same degree. We encourage Ministers to consider and bring forward alternative measures alongside a supplementary business rate to allow local authorities and local business communities seeking additional funds for local investment to choose a means which is suitable for their specific local circumstances.

**SBR in two-tier areas**

40. Although he noted that “in theory a supplement could be levied at any tier of local government”, Sir Michael proposed in the interests of transparency and efficiency that “only upper tier authorities should levy supplements” and that “in two-tier areas, those proposals should be the subject of discussion and agreement between the county and the district councils”. For our witnesses, this proved one of the most controversial aspects, with many questioning the wisdom of denying second-tier authorities the right to initiate an SBR. Kent County Council set out firmly the difficulties that would be inherent in

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45 Q 98
46 Q 98
47 Lyons report, para 8.62
securing agreement between the upper tier authority and the 12 district authorities within its area. These include confusion over distribution of revenue among districts and between districts and the county council; the potential for additional bureaucracy which may be involved in having numerous different processes for securing business agreement and the inherent risk of some districts agreeing to a county-wide levy when others did not.48 Lynda McMullan, Director of Finance at Kent County Council, explained that while an SBR would be collected by district councils (as the collection authorities for NNDR), much of the demand for expenditure could be at county level and that, as a result, two-tier areas could expect “a lot of, in the nicest possible way, very thrusting debate about what those priorities will be”.49 Mr Brooks, of Dartford District Council, thought SBR was “just an unnecessary complication” in two-tier areas.50

41. In contrast a number of witnesses argued that an SBR should be levied district by district rather than subject to county-wide agreement. Predictably, second-tier councils featured strongly among this group but a similar call was made by others including the Rating Surveyors’ Association which said that being levied by upper-tier authorities would make an SBR a “crude tool and unlikely to receive support.”51

42. We recognise the additional difficulties and complexities that may be involved in securing agreement to levy a county-wide SBR in two-tier areas. We recommend that upper-tier authorities should be empowered to propose an SBR in co-operation with second-tier authorities in their area. We also recommend that second-tier authorities have the power to propose an SBR, either individually or jointly with neighbouring districts; and that specific arrangements should be determined by the local authorities involved in conjunction with the local business community, case by case.

London

43. London, itself a two-tier area but with unique governance arrangements, makes a significant contribution to the national economy. The Mayor of London told us that “London is successful and growing, challenging New York as the world’s leading international financial centre. The performance and specialisations of London complement those of the rest of the UK, both in terms of industry and people: when the UK grows, so does London and vice versa”.52 It added that on conservative estimates in 2004-05 London contributed between £1 and £8 billion to national coffers through taxation over and above public expenditure in London. London’s importance within the national economy undermines the need to ensure than any new tax burdens are not unduly onerous upon businesses.

48 Memorandum from Kent County Council, SBR 47
49 Q 94
50 Q 94
51 See, for instance, Memoranda from Harrogate Borough Council, SBR 01; Dave Simpson, Head of Corporate Finance, Hambleton District Council, SBR 04; Maidstone Borough Council, SBR 10, para 5.1b; the Rating Surveyors’ Association, SBR 07
52 Memorandum from the Major of London, SBR 45, para 1
44. In London responsibility for most local government functions lies with the 32 boroughs and the Corporation of London but various strategic powers and functions, including planning and transport, rest with the Greater London Authority. Sir Michael argued that:

[I]t is important that the respective roles and voice of the Mayor and the boroughs are reflected in the approach taken, but that approach must facilitate city-wide action on infrastructure issues and acknowledge the wide variations in the size of the tax base between different parts of the city. The places where infrastructure is required may well not match the pattern of revenue raising.\(^{53}\)

As a result, he proposed what he termed a “more flexible and collaborative” SBR arrangement in which a single, London-wide rate would be set through agreement between the Greater London Authority and the boroughs and in consultation with the business community.\(^{54}\)

45. Sir Michael said he was concerned to maintain simplicity and that only upper tier authorities, such as the GLA, should have powers to levy supplements. Sir Michael argued:

I have reservations about giving supplementary powers to a large number of authorities, given the business community’s concerns about complexity. There is an opportunity, however, to marry a concern for simplicity with an encouragement to collaborative decision-making and the coalition building that is essential to effective place-shaping. I propose that only upper tier authorities should levy supplements. In two-tier areas, those proposals should be the subject of discussion and agreement between the county and the district councils, with a joint plan for the use of the revenues raised to meet the overall needs of the area. This reduces the number of possible different rates to 150, providing a less complex system for businesses, and acknowledges the interest of all levels of elected local government in the revenues raised through the use of the supplementary power.\(^{55}\)

The Mayor of London agreed with Sir Michael that only the upper tier local authority should set the rate, and that therefore in the case of London, only the Mayor would set the SBR. The Mayor also pointed out that a single London-wide SBR would allow the capital to address strategic investment priorities in a transparent manner that would be straightforward to implement. The Mayor also argued that:

The Mayor agrees with Sir Michael Lyons that only the upper tier authority should set the rate and that in London therefore only the Mayor should set a supplementary business rate. Boroughs should not set separate supplementary rates as well. He agrees with Sir Michael Lyons that having potentially an additional 33 business rates in London would be confusing for businesses. Instead, boroughs should still be able, as they can now, to propose [business improvement districts] to tackle local issues, supported where necessary by additional business rate levies.\(^{56}\)

\(^{53}\) Lyons report, para 8.63
\(^{54}\) Lyons report, para 8.64
\(^{55}\) Lyons report, para 8.62
\(^{56}\) Memorandum from the Mayor of London, SBR 45, para 6
Equalisation

46. A further advantage of Sir Michael Lyons suggestion of a single SBR for London is its equalising effect, to ensure that investment is made available where it is most needed. Sir Michael identified through his inquiry concerns about large differentials in tax raising capacity between areas. He wrote:

The power to levy a supplement will not be equally valuable in all areas and the revenues that individual areas could raise would vary substantially […] This raises the concern that it might appear unfair to other parts of the country that these areas could raise substantially greater revenues, and in the past (for example in the Government’s consultation on supplementary rates in 1998) it has been proposed that special arrangements should apply to these areas.57

Sir Michael believes that one way of mitigating these concerns would be through a single London SBR. He pointed out that:

In addition, comparing the revenues from a supplement on a per head of population basis shows that most of the authorities with very large tax bases per head are in London, where the differences should be dealt with through the joint approach between the GLA and the boroughs suggested above.58

The Mayor of London agreed that a single SBR would have an important equalising effect.59 The Mayor argued:

The size of the business tax base across the London boroughs varies enormously and does not necessarily correlate to the places where infrastructure is required. Areas such as Westminster and the City of London have some of the most expensive business properties in the world, while areas of more deprived outer London boroughs such as Waltham Forest, Lewisham and Redbridge have some of the lowest tax bases in the country. A London-wide SBR will ensure equalisation across the capital, as Sir Michael Lyons recognises.60

47. There are two main concerns regarding this proposal. The first is that, by making an SBR London-wide only, there would be no room for more localised action by individual boroughs or groups of boroughs. Unsurprisingly, Councillor Merrick Cockell, Chairman of London Councils, said: “obviously we would not be supportive of a regional-only scheme” and advocated discretion for boroughs to initiate an SBR in their areas.61 He argued that for many small businesses major infrastructure schemes, such as Crossrail, which is a prime candidate for support under a London-wide SBR, were

57 Lyons report, para 8.66
58 Lyons report, para 8.67
59 ‘Comparing the revenues from a supplement on a per head of population basis shows that most of the authorities with very large tax bases per head are in London, where the differences should be dealt with through the joint approach between the GLA and the boroughs suggested above.’ (Lyons report, paragraph 8.67)
60 Memorandum from the Mayor of London, SBR 45, para 8
61 Q 3
just a line on a map and will not have any direct bearing for them. They want to see value literally on their doorstep. If they are going to pay more they will want to see better policing […] perhaps better cleansing of public areas, the sort of things that will attract people not only to come and visit that area and spend their money but will also attract employees.62

48. Councillor Cockell called for “a balance between local, immediate, visible benefit and […] the grand schemes for London”.63 London First, a business membership organisation which includes over 300 of the capital’s major businesses, also favoured enabling boroughs to initiate an SBR, believing that this would help to strengthen the link between rates payments and local services.64 London Councils made a similar argument.65

49. Equally unsurprisingly, the Greater London Authority, which believes firmly that Crossrail should be the first beneficiary of any SBR in London, told us that it was “quite clear that there should be a London-wide rate only”, offering two reasons in support: first, that there was a backlog of underinvestment in infrastructure which a London-wide SBR could address and in doing so assist the whole of London’s economy; and secondly that a profusion of different SBR rates, which might arise if each borough initiated its own supplement, could be confusing for businesses. It pointed out that “London’s economy is one that is very interconnected and highly concentrated”.66 For example, 61 per cent of people live in a different borough from the one in which they work and 30 per cent of London’s workforce is concentrated in just 2 per cent of its geographical area (the West End, City and Isle of Dogs).67

50. Our second concern regarding Sir Michael’s proposals for London centres on the practicality of securing agreement among 32 boroughs, the Corporation of London and the Greater London Authority. London First argued that “it would be very difficult to achieve agreement […] collectively on a programme to be funded in this way […] There would be a high risk of failure to agree anything. If the authorities did succeed in reaching agreement, it would be likely to be based on a stronger emphasis on satisfying their respective aspirations than meeting the concerns of the business community.”68 Both London Councils and the Greater London Authority however appeared confident that agreement could be reached, citing recent examples of healthy co-operation between the boroughs and the Mayor as a firm foundation on which to base future negotiations on supplementary business rates.69 Nevertheless, concerns about the feasibility of securing agreement on a London-wide basis reinforce arguments in favour of greater local discretion.

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62 Q 6
63 Q 6
64 Memorandum from London First, SBR 44, para 13
65 Memorandum from London Councils, SBR 50, para 3
66 Q 4
67 Q 4
68 Memorandum from London First, SBR 44, para 12
69 QQ 21-4
51. Moreover it seems perverse in the extreme to enable upper-tier authorities across the country—including Rutland with its population of 37,000 and capacity to raise a few hundred thousand pounds annually from a 1 pence levy—to initiate an SBR but to deny similar flexibility to London boroughs such as the City of Westminster, with its population approaching quarter of a million and the capacity to raise almost £25 million on the same terms. London boroughs and the businesses in their areas have as much to gain from strengthening the relationship between business and local government and working together to promote economic development as any other local authority. At the same time, we recognise the potential for strategic, London-wide efforts to support London businesses.

52. We agree with Sir Michael Lyons that special arrangements for London are justified on the grounds of its unique governance arrangements and economic circumstances. We do not agree that powers to levy an SBR should rest with the Greater London Authority only. We recommend that the Greater London Authority should have the power to initiate a London-wide supplementary business rate which could only be blocked by a two-thirds majority of London local authorities. In addition individual London boroughs and the Corporation of London should be able to initiate a supplementary business rate either individually or in co-operation with other boroughs.

**Capping the SBR rate?**

53. Sir Michael contemplated rates between 1 and 4 pence in the pound, which would equate to NNDR supplements of between 2.5 and 10 per cent approximately. He suggested that central government should set the maximum rate which could be used arguing that this would offer business some reassurance that an SBR could not become an increasing burden. Provided that, as we recommend, adequate measures are put in place to ensure that an SBR is levied by consent, this precaution seems unnecessarily draconian. It would be rare for a local authority to seek, and for the business community to accept, an SBR involving more than a marginal variation to the NNDR but where those circumstances do come together we see no reason why it should not be allowed. Reassurance for the business community is an important consideration in securing acceptance for SBR in principle as well as in practice but this could be as easily achieved by balloting, perhaps on the ‘dual key’ basis employed in BID establishment, any proposals to vary the NNDR by more than 10 per cent—the highest rate adopted by a BID—without the compromise to local discretion that a statutory cap would represent. **We recommend that the SBR rate should not be capped by central government but determined locally and that where SBR proposals contemplate a local variation, upwards or downwards, of more than 10 per cent, a ballot of the business community should be the norm.**

**Exemptions and discounts**

54. Those calling for a nationally imposed cap upon the rate at which an SBR could be levied would seem to have overlooked a significant barrier to more than marginal variations which is already inherent in the proposal. Local authorities are themselves business rate payers. The total rateable value of public sector properties has been estimated

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70 Projections of SBR revenue taken from the Lyons Report, chart 8.6.
at £4.1 billion as of 1 April 2006, representing some 10 per cent of the gross value of non-
domestic properties. Some of our witnesses pointed out that the local authority was in
some instances among the largest NNDR contributors in an area. Local authorities’
liability for SBR, since it could not be met by the revenue generated, would in the absence
of efficiency savings have to be met either from revenue from central government—which
is increasingly ring-fenced and therefore unavailable for discretionary expenditure—or
from council tax. That local authorities’ SBR contributions are likely to draw upon council
tax receipts, where increases are politically sensitive and the subject of much scrutiny, will
be a significant and useful deterrent to more than marginal variations to the NNDR,
ensuring a level of public scrutiny commensurate with the proposed rate levy. **Local authorities should not be able to exempt or discount the liability of public sector buildings for a supplementary business rate.**

55. The Federation of Small Businesses points out that small businesses already pay three
times as much in business rate, as a proportion of turnover, as larger companies do. The
Government has already introduced a relief for small business against NNDR liability—the
Small Business Rate Relief (SBRR). The question therefore arises of whether exemptions
and discounts for small businesses would be appropriate within any SBR. Nationally, the
smallest 90 per cent of businesses account for only a little over 30 per cent of rateable value.
Sir Michael therefore argued that “a discount or exemption for smaller businesses would
not in most places substantially reduce the yield from a supplement” and suggested that
central government “may wish to protect the smallest businesses through setting a
threshold below which small businesses do not pay a supplement”, although he favoured a
degree of local flexibility. The Head of Corporate Finance at Hambleton District Council
told us that if those businesses with a rateable value below £15,000 were exempted from
SBR, 80 per cent of business in the area would be relieved of liability but expected revenue
would fall by only 26 per cent. This was considered “acceptable” as a means of protecting
small businesses. Several other witnesses favoured a relief for small businesses on the
basis of rateable value or eligibility for SBRR.

56. Despite a risk that discounts or exemption for small businesses “might well be
considered unfair by larger businesses” because they would “effectively have to subsidise
smaller businesses”, the CBI accepted “the case for a threshold to prevent small businesses
being unduly burdened by a new levy”. Nevertheless it pointed out that rateable value is
not always a good measure of company size and that average rateable values can vary
significantly across the country. SIGOMA argued similarly: “different local areas are also
structured very differently, with more or less reliance on smaller businesses as a proportion
of the wider local economy. In many former industrial areas, the demise of heavy industry
has meant the loss of larger businesses and the more recent growth of many different, often
smaller, enterprises.” Such considerations led several of our witnesses to argue for

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71 Lyons report, page 305, fn
72 Memorandum from the Federation of Small Businesses, SBR 06, para 5
73 Lyons report, paras 8.68-9
74 Memorandum from Dave Simpson, Head of Corporation Finance, Hambleton District Council, SBR 04, para 7.5
75 See, for example, Memorandum from Harrogate Borough Council, SBR 01
76 Memorandum from the Confederation of British Industry, SBR 42, paras 22-3
77 Memorandum from SIGOMA, SBR 37, para 9.3
Local Government Finance: Supplementary Business Rate

unfettered local discretion over exemptions and discounts.\textsuperscript{78} While national government has no choice other than to use crude measures to determine eligibility the combined local expert knowledge of the business community and the local authority provides an opportunity for SBR reliefs more finely attuned to the purposes of the supplement and to local economic conditions. \textbf{We therefore recommend that any decisions on exemptions and discounts, other than in relation to the public sector’s liability, are made at local rather than national level.}

\textbf{SBR and Business Improvement Districts}

57. Business Improvement Districts (BIDs) are partnerships between local authorities and local business which provide additional services or improvements to specified areas funded in whole or in part by a levy upon businesses in that area made in addition the NNDR. All non-domestic ratepayers in the area vote on a BID proposal under the dual-key system described earlier. Introduced by the Local Government Act 2003, the first pilot BIDs were established, with support from the then Office of the Deputy Prime Minister, in 2005. There are now 45 BIDs in operation across the UK, with one having already been the subject of a successful renewal ballot.\textsuperscript{79} To date BID levies have ranged from 1 to 4 pence supplements to the business rate. There are similarities in both design and purpose between BIDs and Sir Michael’s conception for supplementary business rates. There are also clear differences between the two initiatives: BIDs operate across much smaller geographic areas than those to which an SBR might be applied; BIDs cannot be established without the clear consent, expressed through a ballot, of a majority of the business community affected, and BID management is business-led.

58. A number of our witnesses were concerned about the impact of supplementary businesses rates on existing BIDs and on the potential to establish more. Sue Ashley, Town Centres and BIDs Manager at Warwickshire County Council, for instance, told us that it would become impossible to secure local businesses commitment to an BID if the prospect of an SBR was also “looming”. In the context of Warwickshire alone, she added “SBR introduction could potentially mean a loss of some £7 million BID income in the next three years”.\textsuperscript{80} Dr Julie Grail of British BIDs explained that such was the degree of price sensitivity, among small and medium-sized businesses in particular, that BIDs would be “hugely threatened” by supplementary business rates.\textsuperscript{81}

59. There is a risk that the introduction of an SBR in an area where a BID already exists might discourage business ratepayers from continuing to support the BID. In theory, a business ratepayer might end up paying two supplements to the NNDR of up to 4 pence in the pound each (equivalent in total to an additional levy of some 20 per cent on top of the NNDR)—one for the BID and one for the SBR. The consensus among our witnesses was that those BIDs which had been established had proved, in the words of the Greater

\textsuperscript{78} See, for example, Memoranda from the Local Government Association, SBR 41; Worcestershire County Council, SBR 38; SIGOMA, SBR 37, para 9.4
\textsuperscript{79} Memorandum from British BIDs, SBR 08, para 2
\textsuperscript{80} Memorandum from Warwickshire County Council, SBR 18, para 3.3
\textsuperscript{81} Q 39
Local Government Finance: Supplementary Business Rate

We would not wish to see existing BIDs discouraged or undermined by the introduction of a local SBR. We therefore recommend that where a supplementary business rate is introduced in an area which includes an existing business improvement district there should be an off-set for BID contributors against their supplementary business rate liability.

60. The position would be different where an SBR had been established before a BID proposal came forward. At this point local businesses could decide whether they wished to contribute to a BID and/or a SBR. Local authorities too will wish to consider which model is most appropriate for their locality. If there is any risk of perverse incentives as the result of BIDs and SBRs operating side by side or in overlapping areas, the Government may wish to consider arrangements to mitigate them.

SBR and the Local Authority Business Growth Incentive

61. Some of our witnesses advocated the retention and extension of the Local Authority Business Growth Incentive (LABGI) either as an alternative to or to sit alongside supplementary business rates. The Chief Economic Development Officers’ Society told us that “even if a supplementary business rate is introduced” it believes that “an improved and strengthened LABGI should be retained as an important incentive to local authorities to support the promotion and improvement of their local economies”. LABGI was first announced by the Chancellor of the Exchequer in the 2002 Pre-budget report and came into operation in 2005. It is intended to give local authorities an incentive to encourage economic growth in their areas by allowing them to retain a proportion of any increase in business rate revenues above a specified level. LABGI was predicted to be worth up to £1 billion to local authorities over a three-year period and the extra resources generated are entirely additional for the local authority. No business pays more under the scheme than it would have done in its absence.

62. Initially criticised for its complexity—one of our witnesses referred to it as a “great idea mucked up by civil servants” while another argued that it was “fine in theory but […] hopelessly flawed in practice”—changes announced in September 2006 removed some complications but also imposed an upper limit of £400 million on LABGI grants for 2006. Some of these simplifications where subsequently overturned by Judicial Reviews brought by Corby and Selby Borough Councils. The sums generated by LABGI are useful but not large in the context of local government finance—a total of £127 million in the first year and £316 million in 2006, although the Government expects this figure to rise rapidly. Moreover, it is difficult to predict in advance how much any individual local authority will receive so local authorities could not sensibly rely on the proceeds of LABGI to finance major projects. Some of our witnesses were critical of the scheme on the grounds that while the additional revenue arose directly from business growth, there was no

82 Memorandum from the Mayor of London, SBR 51, para 4
83 See, for instance, Q 87
84 Memorandum from the Chief Economic Development Officers’ Society, SBR 16, para 12
85 Q 87
86 Budget Report, March 2007, para 3.81
87 See, for instance, memorandum from Chief Economic Development Officers’ Society, SBR 16, para 11
requirement to use the proceeds for investment in further economic development. The Government is expected to announce further reform of LAGBI shortly.

63. There are real benefits to be gained from providing a direct financial incentive to local authorities to promote economic development. This aspect of the Local Authority Business Growth Incentive is in principle attractive but is not a substitute for the more sophisticated approach to economic development which the SBR proposals represent. The unpredictability and the low level of additional revenue generated by the Local Government Business Growth Incentive make it an unsuitable alternative.

**Longer-term consequences**

64. Sir Michael’s proposals for reforming local government finance include local discretion for marginal variations to the business rate; measures, including a re-branding, to increase take up of council tax benefit; and the reform or removal of certain reliefs, particularly in respect of empty properties. However sensible such reforms may be—and however welcome the Government’s swift enactment of the latter—even in combination they are no more than incremental, evolutionary changes, falling far short of the radical rebalancing of power sought by several of our witnesses and many of Sir Michael’s. We understand, indeed we support, this more cautious approach. Given the long history of radical but ineffective proposals for reform in the past, such an approach is not timid but pragmatic. Nevertheless, we agree that more is needed if local authorities are to become the leaders of vibrant communities and the engines of local economic development. The recent Green Paper, *The Governance of Britain*, contemplates “enabling local communities to take decisions about how to use local funds” and ensuring “that local priorities are being met” and promises exploration of possibilities for allowing local residents to apply for devolved and delegated budgets. Similarly, the Rt hon. Hazel Blears said in her first major speech following her recent appointment as Secretary of State for Communities and Local Government: “Devolving power from Whitehall to the town hall, and from the town hall to local communities is not just the right thing to do. It’s the most effective way to build places where people are proud to live, work and raise their family. It’s the surest way to make public services meet people’s needs. And it’s the only way we can meet some of today’s biggest challenges—from climate change, to community cohesion.” Increasing business engagement with local authority revenue, expenditure and activity should go hand in hand with such developments. The Government should consider implementation of Sir Michael’s recommendations on local government revenue not as the last word but the beginning of a development process of financial devolution. Its response to the Lyons report should set out how and when the next steps might be taken.

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88 Memorandum from the British Chambers of Commerce, SBR 09 para 2.3
89 Budget report, March 2007, para 3.81; Sun-national review of economic development and regeneration, July 2007, para 6.31
90 Ministry of Justice, *The Governance of Britain*, Cm 7170, July 2007, paras 176-7
91 Speech by Rt hon. Hazel Blears MP, Secretary of State for Communities and Local Government, to the Local Government Association Conference, July 2007 (http://www.communities.gov.uk)
65. Research shows that when in the 1980s the business rate was suspended for properties in Enterprise Zones, rental values rose to offset the tax relief: in effect property became more valuable as a result of a lower tax liability. Given a causal link between tax liability, rents and property value, it is arguable that rental values and consequently over time rateable values may fall if SBRs are introduced at anything other than a nominal level, albeit with a time delay as business property is re-valued only once every five years and occupiers often have multi-year tenancy agreements with landlords. The statutory RPI cap on NNDR increases means that one potential consequence of a long-term decline in rateable values is a reduction in NNDR revenue. Businesses would pay less to central Government, central Government would have less NNDR money to re-distribute to local authorities, and so a greater proportion of the burden of local authority expenditure may fall to be met from general taxation.

66. SBR is designed to increase economic activity and stimulate economic growth. As Sir Michael explains:

> The objective behind introducing greater local flexibility is to enable authorities to invest in infrastructure and other activities, which enhance local quality of life and the distinctiveness of places, and support economic development and growth. Where spending is targeted well on such areas it should support an expansion in the number and success of businesses and the value of the properties in an areas, offsetting the negative impact of the supplement.92

Under current NNDR arrangements, there is little incentive in terms of additional direct revenue for local authorities to work towards increasing the business tax base. The introduction of an SBR would provide such an financial incentive as local business growth would result in an increase in local revenues. Nevertheless, it is important than the taxpayer is also protected from any perverse consequences of desirable economic development. **We recommend that the Government monitor the long-term impact of supplementary business rates on the rateable values of business properties.**

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92 Lyons report, para 8.76
Revenue investment

67. Sir Michael indicated that revenue raised by SBR should be used to support projects and measures agreed by the local business community and aimed at promoting economic development. Some have interpreted this broadly, envisaging schemes similar to those supported by existing BIDs (the Rugby BID, for instance, provides a range of local services including CCTV security and street cleaning) or by the Corporation of the City of London, which provides additional security and police through its uniquely held power to vary the NNDR locally.93 Sue Ashley, Town Centres and BIDs Manager for Warwickshire County Council, told us that local businesses see these projects “as being a priority for their own trading environment”, projects that are “really going to make a difference to their turnover and footfall”.94 Mr Wiles told us of the City of York’s desire to improve the business environment through diverse means such as additional park and ride services, or a new tourist information centre: “there is a whole variety of things which would boost local business, particularly in the city centre”.95

68. Many however have interpreted Sir Michael’s intention more narrowly, envisaging that SBR revenue would be used only to support infrastructure, or even transport infrastructure exclusively. Others, such as the Federation of Small Businesses, argue that such a restriction should apply even if it was not the original intention.96 The British Chambers of Commerce stated that “businesses would only consider an SBR for investment in transport infrastructure”.97 A recent report from the Centre for Cities, City Leadership, and its ongoing work on city transport both frame SBR in the context of transport infrastructure and in its evidence to us, the Centre noted that support for SBR was strongest in those centres where there were clearly defined infrastructure needs.98 In its February 2007 report, Loosening the Leash, the All-Party Urban Development Group, backed an SBR “as part of a wider tool-kit for local authorities to invest in transport infrastructure”.99

69. Even in major urban centres, levying a supplement at the maximum rate envisaged in the Lyons report, four pence, may not generate sufficient revenue to finance major infrastructure projects. Leeds Chamber of Commerce and Industry estimated that at this rate, additional annual revenue in Leeds would be £27 million, permitting borrowing over 25 years to the tune of £300 million, significantly less than, for instance, the estimated costs of between £500 million and £1 billion of the Leeds Supertram.100 An SBR could nevertheless make a significant contribution to large-scale projects. In Leeds the City Council is keen to support “infrastructure investment linked to economic regeneration” through projects such as the regeneration in the Aire Valley Employment Area and the

93 Memorandum from the City of London Corporation, SBR 12, para 5
94 Q 37
95 Q 95
96 Memorandum from the Federation of Small Businesses, SBR 06, para 7.1
97 Memorandum from the British Chambers of Commerce, SBR 09, para 2.2
98 Memorandum from Centre for Cities, SBR 17, para 17
99 Memorandum from Centre for Cities, SBR 17, para 19
100 Memorandum from Leeds Chamber of Commerce and Industry, SBR 29, para 8
development of Leeds and Bradford Airport. It told us that while the revenue raised from SBR would be unlikely to satisfy investment needs, “it could be a significant element of a larger and more complex funding package.”

70. In some areas the questions over investment priorities may turn less on whether SBR can support major infrastructure projects than on whether other projects may be more appropriate and more effective in improving the business environment. In larger, disparate, and more economically and geographically differentiated areas, it may not be easy to identify single major infrastructure improvements that would benefit the whole business community directly. Even in respect of London, Councillor Cockell, the Chairman of London Councils, warned against a succession of “grand schemes”, inviting consideration of smaller-scale, perhaps borough-wide rather than London-wide, schemes.

71. Many, particularly local authorities and businesses, are united in believing investment in infrastructure and transport infrastructure in particular is a priority. There is potential for SBR to contribute towards, even if not to support in entirety, a range of infrastructure improvements. The experience with BIDs however has demonstrated that smaller-scale projects can also make a significant difference to the business environment. We recommend that local authorities and local businesses should be free to determine jointly their own investment priorities.

72. Although he argued that individual SBR proposals should include a clear timetable, Sir Michael did not favour a universal time limit. We agree. While a clear timetable is an important element in providing certainty and predictability for the local authority as well as the business community, investment, in infrastructure projects in particular, may need to be financed over a number of years—it is not unusual for major infrastructure projects to take 25 to 30 years—and perhaps more than originally expected. Sir Michael suggests that extending the duration of an SBR beyond original intentions should require renewed approval from local ratepayers. This however raises the possibility of an SBR which finances a long-running capital project being approved at the outset but being withdrawn before the project is completed. In these circumstances and under current arrangements there would be little option other than for the council tax payer to meet the costs of completion. This is unacceptable. In the case of major infrastructure projects, where SBR revenue is likely to form only part of an overall package of funding, the feasibility of an SBR with a fixed duration will need to be considered against the stability of other funding streams. We recommend that SBR proposals include a clear timetable pegged to project milestones rather than absolute time periods where this is more appropriate. The timetable should include safeguards for both ratepayers and council tax payers against project overruns and, in the case of council tax payers, against any long-term financing costs arising from SBR projects.

101 Memorandum from Leeds City Council, SBR 26, para 5
102 Q 8
Conclusions and recommendations

1. We regret that, despite the series of reviews of local government finance that have taken place over the last 30 years, from the Layfield Committee onwards, there has under successive Governments been little change designed to create a funding system that supports and enables local authorities to fulfil their role as ‘strategic place-shapers’. We agree with Sir Michael Lyons that reforming local government finance is a key component in empowering local authorities. There is no excuse for the Government to squander the opportunity to develop an agenda for change alongside its response to the Lyons report, its implementation of the 2006 Local Government White Paper and reforms contemplated in the recent Green Paper, Governance of Britain. (Paragraph 16)

2. We recommend a statutory requirement be imposed that SBR revenues are ring-fenced. The purposes to which SBR revenues can be applied should be restricted by statute to those specific projects and schemes deemed by the local authority and the business community to benefit the local business environment and identified in the initial proposals for the levy. (Paragraph 27)

3. Local businesses’ acceptance of levy proposals and spending plans, secured through a ballot or demonstrated through consensus-building consultation, should be achieved before any SBR is imposed. Sir Michael Lyons’s recommendation was that there should be no requirement for a ballot on SBR proposals within the affected business community. We agree. Local Authorities should, however, remain free to hold a ballot when local or specific circumstances warrant. (Paragraph 35)

4. The facility to levy a supplementary business rate is most attractive for unitary authorities covering urbanised metropolitan areas. We are concerned that other areas, particularly less urbanised and rural parts of the country, would not be able to benefit or not to the same degree. We encourage Ministers to consider and bring forward alternative measures alongside a supplementary business rate to allow local authorities and local business communities seeking additional funds for local investment to choose a means which is suitable for their specific local circumstances. (Paragraph 39)

5. We recognise the additional difficulties and complexities that may be involved in securing agreement to levy a county-wide SBR in two-tier areas. We recommend that upper-tier authorities should be empowered to propose an SBR in co-operation with second-tier authorities in their area. We also recommend that second-tier authorities have the power to propose an SBR, either individually or jointly with neighbouring districts; and that specific arrangements should be determined by the local authorities involved in conjunction with the local business community, case by case. (Paragraph 42)

6. We agree with Sir Michael Lyons that special arrangements for London are justified on the grounds of its unique governance arrangements and economic circumstances. We do not agree that powers to levy an SBR should rest with the Greater London Authority only. We recommend that the Greater London Authority should have the
power to initiate a London-wide supplementary business rate which could only be blocked by a two-thirds majority of London local authorities. In addition individual London boroughs and the Corporation of London should be able to initiate a supplementary business rate either individually or in co-operation with other boroughs. (Paragraph 52)

7. We recommend that the SBR rate should not be capped by central government but determined locally and that where SBR proposals contemplate a local variation, upwards or downwards, of more than 10 per cent, a ballot of the business community should be the norm. (Paragraph 53)

8. Local authorities should not be able to exempt or discount the liability of public sector buildings for a supplementary business rate. (Paragraph 54)

9. We recommend that any decisions on exemptions and discounts, other than in relation to the public sector’s liability, are made at local rather than national level. (Paragraph 56)

10. We recommend that where a supplementary business rate is introduced in an area which includes an existing business improvement district there should be an off-set for BID contributors against their supplementary business rate liability. (Paragraph 59)

11. There are real benefits to be gained from providing a direct financial incentive to local authorities to promote economic development. This aspect of the Local Authority Business Growth Incentive is in principle attractive but is not a substitute for the more sophisticated approach to economic development which the SBR proposals represent. The unpredictability and the low level of additional revenue generated by the Local Government Business Growth Incentive make it an unsuitable alternative. (Paragraph 63)

12. The Government should consider implementation of Sir Michael’s recommendations on local government revenue not as the last word but the beginning of a development process of financial devolution. Its response to the Lyons report should set out how and when the next steps might be taken. (Paragraph 64)

13. We recommend that the Government monitor the long-term impact of supplementary business rates on the rateable values of business properties. (Paragraph 66)

14. We recommend that local authorities and local businesses should be free to determine jointly their own investment priorities. (Paragraph 71)

15. We recommend that SBR proposals include a clear timetable pegged to project milestones rather than absolute time periods where this is more appropriate. The timetable should include safeguards for both ratepayers and council tax payers against project overruns and, in the case of council tax payers, against any long-term financing costs arising from SBR projects. (Paragraph 72)
Formal minutes

Wednesday 25 July 2007

Members present:

Dr Phyllis Starkey, in the Chair

Sir Paul Beresford
Mr Clive Betts
Mr Greg Hands
Anne Main

Mr Bill Olner
Dr John Pugh
Emily Thornberry
David Wright

Supplementary Business Rate

Draft Report (Supplementary Business Rate), proposed by the Chairman, brought up and read.

Ordered, That the Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 34 read and agreed to.

Paragraph 35 read, as follows:

“Local businesses’ acceptance of levy proposals and spending plans, secured through a ballot or demonstrated through consensus-building consultation, should be required before any SBR is imposed. Sir Michael Lyons’s recommendation was that there should be no requirement for a ballot on SBR proposals within the affected business community. We agree. Local Authorities should, however, remain free to hold a ballot when local or specific circumstances warrant. In deciding whether to ballot, local authorities will wish to weigh the likelihood of securing sufficient business acceptance for specific SBR proposals without a ballot against the additional costs and complexities which may be involved”.

Amendment proposed, in line 5, after the word “community.” to leave out the words “We agree.”—(Dr Pugh.)

Question put, That the Amendment be made.

The Committee divided.

Ayes, 3
Sir Paul Beresford
Anne Main
Dr John Pugh

Noes, 4
Mr Clive Betts
Mr Bill Olner
Emily Thornberry
David Wright

Paragraph agreed to.

Paragraphs 36 to 49 read and agreed to.

Paragraph 50 read, as follows:
“Our second concern regarding Sir Michael’s proposals for London centre on the practicality of securing agreement among 32 boroughs, the Corporation of London and the Greater London Authority. London First argued that “it would be very difficult to achieve agreement [...] collectively on a programme to be funded in this way [...] There would be a high risk of failure to agree anything. If the authorities did succeed in reaching agreement, it would be likely to be based on a stronger emphasis on satisfying their respective aspirations than meeting the concerns of the business community.” Both London Councils and the Greater London Authority however appeared confident that agreement could be reached, citing recent examples of healthy co-operation between the boroughs and the Mayor as a firm foundation on which to base future negotiations on supplementary business rates. Nevertheless, concerns about the feasibility of securing agreement on a London-wide basis reinforce arguments in favour of greater local discretion”.

An amendment proposed, in line 11, to leave out from the word ‘rates’ to the end of the paragraph, and to add the words:

“However, the Mayor of London also pointed out that reaching agreement between 33 local authorities might be challenging. The Mayor’s view was that:

he should set the SBR following consultation with the 33 London local authorities as well as London business. He does not believe that it is practicable that he should reach agreement with all 33 local authorities in London. He is the directly elected Mayor whose responsibility is to make strategic decisions for the improvement of the whole capital rather than single boroughs. Having to provide specific benefits for 33 local authorities would be impractical, would not be transparent to all Londoners, would risk short-termism and agreement may be impossible to reach in any case. It is therefore much more appropriate for the Mayor to consult on his strategic proposals with London’s local authorities as part of determining the supplementary business rate.

Concerns about the feasibility of securing agreement on a London-wide basis reinforce arguments ensuring that a framework that allows clear strategic decision-making is put in place, so that necessary investment can be made”.—(Emily Thornberry.)

The Committee divided.

Ayes, 1
Emily Thornberry

Noes, 6
Sir Paul Beresford
Mr Clive Betts
Anne Main
Mr Bill Olner
Dr John Pugh
David Wright

Paragraph agreed to.

Paragraph 51 read, as follows:
“It seems perverse in the extreme to enable upper-tier authorities across the country—including Rutland with its population of 37,000 and capacity to raise a few hundred thousand pounds annually from a 1 pence levy—to initiate an SBR but to deny similar flexibility to London boroughs such as the City of Westminster, with its population approaching quarter of a million and the capacity to raise almost £25 million on the same terms. London boroughs and the businesses in their area have as much to gain from strengthening the relationship between business and local government and working together to promote economic development as any other local authority. At the same time, we recognise the potential for strategic, London-wide efforts to support London businesses”.

Question put, That the paragraph stand part of the Report.

The Committee divided.

Ayes, 1
Emily Thornberry

Noes, 6
Sir Paul Beresford
Mr Clive Betts
Anne Main
Mr Bill Olner
Dr John Pugh
David Wright

Paragraph agreed to.

Paragraph 52 read, as follows:

“We agree with Sir Michael Lyons that special arrangements for London are justified on the grounds of its unique governance arrangements and economic circumstances. We do not agree that powers to levy an SBR should rest with the Greater London Authority only. We recommend that, in addition to the powers for the Greater London Authority and London boroughs to initiate a levy by agreement and in consultation with the business community, individual London boroughs and the Corporation of London should be able to initiate an SBR either individually or in cooperation with other boroughs”.

Amendment proposed, in line 3, to leave out from the words 'We do not agree' to the end of the paragraph and add the words:

“We share the concern of Sir Michael and the Mayor of London that multiple SBRs for different boroughs could be confusing for business. We also agree with their view that multiple SBRs would not mitigate concerns about unfairness where there are large differentials in the sums that different London boroughs can raise. We believe that the fact that London is highly interconnected and much of its infrastructure is shared, requires the directly elected Mayor to be responsible for making strategic decisions for the improvement of the whole capital. Further, we agree with the view of the Mayor of London that requiring the Mayor of London and all 33 boroughs to reach agreement on a single SBR would hamper much vital strategic investment. We recommend that the Mayor of London in consultation
with London boroughs and the business community should be able to raise an SBR”.—(Emily Thornberry.)

The Committee divided.

Ayes, 1
Emily Thornberry

Noes, 6
Sir Paul Beresford
Mr Clive Betts
Anne Main
Mr Bill Olner
Dr John Pugh
David Wright

Paragraph agreed to.

Paragraphs 53 to 72 read and agreed to.

Summary agreed to.

Resolved, That the Report be the Seventh Report of the Committee to the House.

Ordered, That the Chairman make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

Several Memoranda were ordered to be reported to the House for printing with the Report.

[Adjourned till Tuesday 9 October at 10.20 am]
Witnesses

The following oral evidence is published in volume II of this report, HC 719-II

Tuesday 19 June 2007

Cllr Merrick Cockell and Stephen Lord, London Councils and Jeremy Skinner, The Mayor’s Office, the Greater London Authority

Karen Dee, The Confederation of British Industry, Dr Julie Grail, British BIDs and Sue Ashley, Town Centres and BIDs Manager, Warwickshire County Council

Lynda McMullan and Nick Chard, Kent County Council, Steve Brooks, Dartford Borough Council, Simon Wiles, City of York Council and Dermot Finch, Director, Centre for Cities
List of written evidence

The following memoranda are published in volume II of this report, HC 719-II

Harrogate Borough Council SBR 1
Institute of Value Management SBR 2
Cheshire County Council SBR 3
Head of Corporate Finance, Hambleton District Council SBR 4
Association of Charity Shops SBR 5
Federation of Small Businesses SBR 6
Rating Surveyor’s Association SBR 7
British BIDs SBR 8
British Chambers of Commerce SBR 9
Maidstone Borough Council SBR 10
Canterbury City Council SBR 11
City of London Corporation SBR 12
Devon County Council SBR 13
Royal Institution of Chartered Surveyors SBR 14
County Councils Network SBR 15
The Chief Economic Development Officers’ Society SBR 16
Centre for Cities SBR 17
Warwickshire County Council SBR 18
City of York Council SBR 19
Institute of Directors SBR 20
Yorkshire & Humber Chambers of Commerce SBR 21
Manchester City Council SBR 22
Association of Town Centre Management and UK BIDs SBR 23
Derby City Council SBR 24
Chartered Institute of Public Finance and Administration SBR 25
Leeds City Council SBR 26
Hertfordshire County Council SBR 27
Institute of Revenues Rating & Valuation SBR 28
Leeds Chamber of Commerce and Industry SBR 29
Department for Communities and Local Government SBR 30
East Sussex County Council SBR 31
Craven District Council SBR 32
Birmingham City Council SBR 33
Sheffield City Council SBR 34
Nottingham City Council SBR 35
Richmondshire District Council SBR 36
Special Interest Group of Municipal Authorities (SIGOMA) SBR 37
Worcestershire County Council SBR 38
Tesco 
Ashford Borough Council 
Local Government Association 
Confederation of British Industry 
British Property Federation 
London First 
Greater London Authority – The Mayor of London’s Office 
Mr Peter Webb, Chairman, Surrey Tax Action Group 
Kent County Council 
Selby District Council 
British Retail Consortium 
London Councils 
Head of Strategic Projects and Policy Evaluation, The Mayor of London’s Office 

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List of Reports from the Committee during the current Parliament

The reference number of the Government’s response to each Report is printed in brackets after the HC printing number.

**Session 2006–07**

| First Report | The Work of the Committee 2005-2006 | HC 198 |
| Second Report | Coastal Towns | HC 351 (Cm 7126) |
| Third Report | DCLG Annual Report 2006 | HC 106 (Cm 7125) |
| Fourth Report | Is there a Future for Regional Government? | HC 352-I (Cm 7119) |
| Fifth Report | Refuse Collection | HC 536-I |
| Sixth Report | Equality | HC 468 |
| Seventh Report | Local Government Finance – Supplementary Business Rate | HC 719 |
| Eighth Report | Local Government Finance – Council Tax Benefit | HC 718 |

**Session 2005–06**

| First Report | ODPM Annual Report and Accounts | HC 559 (HC 1072) |
| Second Report | Re-licensing | HC 606 (Cm 6788) |
| Third Report | Affordability and the Supply of Housing | HC 703-I (Cm 6912) |
| Fourth Report | The Fire and Rescue Service | HC 872-I (Cm 6919) |
| Fifth Report | Planning-gain Supplement | HC 1024-I (Cm 7005) |
| First Special Report | Government Response to the Committee’s Fourth Report of Session 2004-05, on the ODPM Annual Reports and Accounts 2004 | HC 407 |
| Second Special Report | Government Response to the Committee’s Eleventh Report of Session 2004-05, on the Role and Effectiveness of The Local Government Ombudsmen for England | HC 605 |
| Third Special Report | Government Response to the Committee’s Seventh Report of Session 2004-05, on the Role and Effectiveness of the Standards Board for England | HC 988 |
| Fourth Special Report | Government Response to the Committee’s First Report of Session 2005-06, on the ODPM Annual Report and Accounts 2005 | HC 1072 |