LONDON CHAMBER of COMMERCE AND INDUSTRY

Written evidence submitted by the London Chamber of Commerce and Industry

London Chamber Of Commerce and Industry Response to Call for Evidence for City Growth Commission

6th January 2014

Executive Summary

1. London Chamber of Commerce and Industry (LCCI) believes that the **current devolutionary settlement for London can be best described as an improvement on having no city government whatsoever, but it is still incomplete and unsatisfactory.**

2. The business environment in London can be improved if local government is given a stake in economic growth through greater fiscal devolution. We recommend:

    A. All property taxes collected within the Greater London Authority (GLA) area should be retained by the GLA and London local authorities (LA).

    B. The GLA should have the power to set the rates, hold re-evaluations and determine the banding of all retained taxes. London LAs should also be able to vary the rates of the taxes which they collect, within reasonable limits.

    C. Borrowing limits for the GLA group, including Transport for London (TfL), should be removed along with limits on LA housing revenue accounts, so long as they meet existing prudential borrowing requirements.

3. Additional funds raised through the retention of existing taxes should be off-set by a commensurate reduction in the overall central government grant to the GLA, so that any fiscal devolution to London will not negatively impact on the grant received by any other UK city or region.

Introduction

4. London Chamber of Commerce and Industry (LCCI) is the capital's largest and most representative business organisation with 2,500 member companies from across Greater London. LCCI membership ranges from small- and medium-sized enterprises through to multi-national corporates. LCCI member companies operate within a mix of sectors, across the Greater London area, genuinely reflecting the broad spectrum of London business.

5. LCCI has experienced various governance models for London throughout its 133 year history, from the Metropolitan Board of Works (1855-1889), the London County Council (1889-1964), the Greater London Council (1964-1986), no city-wide government whatsoever (1986-2000) to the creation of the Greater London Authority and the Office of the Mayor of London at the turn of the millennium to the

present. Given the breadth of our membership and the length of our history, we believe we are ideally placed to comment on how different models of city government have impacted on the economic growth of London and what needs to change with the current devolutionary settlement in order for city government to realise the capital's full economic potential.

6. Therefore, we have chosen to limit our submission to a detailed response to question 6 (regarding the economic and revenue levers that cities require to "make multi-polar growth a reality"). Moreover, given the location of our membership base in London, this submission will only refer to changes to the capital. However, there is no reason why the principles for additional fiscal powers for the capital could not be replicated to other UK cities; indeed, greater fiscal devolution to, and the resulting economic growth of, all core cities would be desirable for our members, just as the growth of London benefits the rest of the UK.

Q6. What needs to change between Whitehall and our cities to make multi-polar growth a reality? What does the centre need to do to enable and what economic and revenue levels do cities require?

7. Our answer will be structured in the following manner:

- "An Appraisal of the Current Devolutionary Settlement for London"
    - The relationship between local government and the business community
    - Challenges to efficiently delivering key infrastructure projects.
- "What Needs to Change"
    - Which fiscal powers should be devolved?
    - Which authorities should be responsible for setting the rates, thresholds and exemptions for locally retained taxation?
    - Should borrowing restrictions for local and regional government should be lifted?
    - What will this mean for London's relationship with the rest of the UK?

An Appraisal of the Current Devolutionary Settlement for London

8. The creation of the GLA as a strategic authority, the office of the Mayor of London and a 25 member Assembly with scrutiny powers in 1999 has been overwhelmingly positive for London, Londoners and London businesses. Successive Mayors have championed London in Whitehall for a better financial settlement and around the world in the search for foreign direct investment. The GLA has been invaluable in highlighting where deficiencies exist in London's services and infrastructure, and how these could be hampering its competitiveness.

9. While the ability to identify challenges, forecast increased demand and scope potential remedies has been useful, it is regrettable that the GLA and London LAs remain powerless to act in the strategic interests of the capital. This inability stems from the fact the GLA and London local government have little control over their revenues and are dependent on a grant from central government that is unpredictable and often set without consultation.

10. The lack of ownership over revenue streams results in two deficiencies in London governance that hinder economic growth:

    A. There is no link between local government revenues and local economic growth, so local government policymakers tend to prioritise politically expedient decisions at the expense of those that create a better environment for business in the long term.

    B. Uncertainty over revenue streams and unnecessary restrictions on borrowing mean both the GLA and London LAs are unable to finance vital infrastructure investment without the consent of the Treasury (HMT). This impairs the GLA's value as a strategic body that is tasked with delivering the infrastructure necessary to make economic and demographic growth sustainable.

11. **Until these two issues are addressed, London's current devolutionary settlement should be considered incomplete and unsatisfactory.**

The relationship between London local government and the business community

12. Until April 2013, there was no financial incentive for London government to encourage economic growth as they were unable to retain any growth in business rate yields. This means that local government policymakers are actively disincentivised from making decisions that will improve the business environment if it comes into conflict with other interest groups that are able to vote in local elections.

13. Even after the Local Government Finance Act (2012) introduced the Business Rate Retention Scheme (BRRS), councils only benefit if they permit new forms of physical growth in their area, placing LAs in London (where there is little physical space to grow) at a disadvantage. The decision to exclude increases in rateable value from the BRRS means that councils have no financial incentive to improve the economic viability of their area through improving community safety or investing in infrastructure or the public realm. **Even after reform, council incentives continue to be institutionally separated from the needs of business.**

14. This was demonstrated by the LCCI report *Driving Local Growth: The Business Case*[1], in which businesses were asked what should be the top priority for their local council and the top three responses were "investing in local infrastructure" (62% of respondents), "improving community safety" (40%) and maintaining the built environment (35%).

15. The same report found that just 12% of London businesses felt that their local council was aware of their needs as a business. If London LAs (and the GLA) were given a stake in the success of their local businesses through ownership and retention of 100% of business rates, it is likely that engagement with the business community would improve, confidence in the local council would increase and more decisions made by local government would be positive for the local economy rather than directed at the interests of a small group of residents. Retaining and spending the taxes that most pay locally would improve accountability and transparency, remove complication and add no significant costs to the collection process.

16. **In order for London to grow, the GLA and London local authorities need to have the financial incentive to make economically positive decisions.**

Efficient, cost-effective infrastructure delivery

17. The dependence of the GLA and London LAs on an unpredictable central government grant means that they are prevented from planning as far ahead into the future as a strategic authority ought to be able to and are therefore unable to raise the finance necessary to deliver the necessary improvements in infrastructure and public services. Moreover, restrictions on borrowing beyond the existing prudential borrowing code prevent the GLA and London LAs from independently financing major infrastructure projects, leaving them reliant on the cooperation of HMT.

18. An example of where this arrangement has severely hindered essential infrastructure investment is Crossrail. Proposals for a new link on the rough axis of the current design can be found in the Abercrombie plans for London of the 1940s. The earliest mention of the term "Crossrail" in LCCI archives is found in a policy paper from 1973. The term then appears in the London Rail Study of 1974[2]

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[1] LCCI, *Driving Local Growth: The Business Case* (2012)
[2] "Crossrail – from its early beginnings" http://www.crossrail.co.uk/route/crossrail-from-its-early-beginnings

and the Central London Rail Study of 1989[3]. A parliamentary bill to build the line fell at Committee Stage in the early 1990s[4]. A Hybrid Bill was introduced to Parliament in 2005, receiving Royal Assent in 2008. Construction work began in mid-2009 but the project was still at risk of being cancelled during the 2010 Comprehensive Spending Review (CSR). It is now anticipated that the first trains will run on the line by 2018. **Despite the years of prevarication from central government, over 60% of the funding for the project will come from the GLA group, London LAs, London businesses and Londoners[5].**

19. There are also relevant international comparisons to be made between how the enhanced fiscal powers of London's competitors have enabled better infrastructure planning and delivery (examples of which are relevant to your investigation of Q2):

    A. Around three-quarters of the income of the GLA and London LAs is dependent on central government grants. TfL is reliant on funding from the DfT, which in the 2013 CSR confirmed TfL's funding up to financial year 2015/16[6]. The spending review also confirmed that the TfL's borrowing would be limited to £600m[7].

    B. By contrast, just 17.5% of Paris' income is dependent on central government grants and its transport authority has a funding settlement guaranteed up until 2030[8]. **This has enabled the development of the "Grand Paris" plans, which include the building of a new, 130km long metro line with 40 stations across the Paris area, which is set to open in 2025[9]**.

20. Paris is not alone in the degree of its fiscal independence: 37% of Madrid's income is dependent on central government grant, falling to 30.9% in New York, 25.5% in Berlin and 7.7% in Tokyo[10]. **London, with 73.9% of its income dependent on central government, is an extreme outlier.**

21. London will have 1.6m extra residents by 2030[11] and over half a million new jobs, yet its ageing infrastructure is already struggling to cope with current population demands, be it a shortage of affordable homes, overcrowded trains or slow broadband connections. London cannot afford delay in delivering the vital infrastructure projects required to ensure that the projected economic and demographic growth is sustainable.

22. The efficient and cost-effective delivery of infrastructure can only be achieved if there is a known and credible pipeline of projects alongside which finance has been guaranteed. The delivery of this infrastructure will create jobs and distribute prosperity well beyond the GLA area – 62% of businesses that won contracts for the construction of Crossrail are located outside of London[12].

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[3] Department of Transport, Central London Rail Study, map 6, p.32 (1989) http://www.railwaysarchive.co.uk/documents/DoT_CentralLondonRailStudy1989.pdf
[4] Crossrail Bill, session 1991/92, subsequently carried over as Crossrail Bill, session 1992/93.
[5] "Funding", http://www.crossrail.co.uk/about-us/funding
[6] Letter from P. McCloughlin to B. Johnson, p.1 (2013) http://www.tfl.gov.uk/assets/downloads/corporate/spending-review-2013-funding-agreement-letter-july-2013.pdf
[7] Letter from P. McCloughlin to B. Johnson, table 2 (2013) http://www.tfl.gov.uk/assets/downloads/corporate/spending-review-2013-funding-agreement-letter-july-2013.pdf
[8] Slack, E. "International Comparison of Global City Financing", p.12
[9] J. Lichfield, The Independent, "Sarko's €35 Rail Plan for a 'Greater Paris'" (2009), http://www.independent.co.uk/news/world/europe/sarkos-euro35bn-rail-plan-for-a-greater-paris-1676196.html
[10] Slack, E. "International Comparison of Global City Financing", p.12
[11] GLA Population Projections (2012 Round SHLAA based)
[12] "Suppliers" http://www.crossrail.co.uk/suppliers/

23. **As long as London remains so dependent on central government grants for the majority of its income, the GLA and London LAs will be unable to efficiently deliver the vital infrastructure that London needs to sustain its economic and demographic growth.**

What needs to change?

Which fiscal powers should be devolved?

24. **The GLA and London local government should be able to retain 100% of the entire suite of property taxes (business rates, council tax, capital gains property development tax, stamp duty land tax and the annual tax of enveloped dwellings) collected within the GLA area.** Property taxes are the most appropriate for devolution. The supply of property and land is slow to change, and this immobility creates a steady stream of revenue from the taxes collected. Furthermore, in many cases, LAs are already responsible for collecting them.

25. By devolving all property taxes rather than just one element of them will remove the potential distorted incentives to prioritise one type of development over another. If only Council Tax was devolved, for example, it could lead to the prioritisation of housing over other types of commercial development.

26. **If fully devolved, it is estimated that property taxes could fund 50% of all current GLA and local council services** and would replace the reliance on the ever fluctuating central government grant. This allows London government greater certainty over future income, enabling the timely and cost-effective delivery of infrastructure projects as well as providing the incentives to create a more competitive business environment in order to grow total tax yields.

27. **The additional funding derived from the retention of all property taxes should be met by a commensurate reduction in the grant that the GLA and London LAs receive from the central government.** This way, the impact of fiscal devolution would be neutral for HMT at the point of reform and would not impact upon the settlements of other UK regions and cities.

Which authorities should be responsible for setting the rates, thresholds and exemptions for locally retained taxation?

28. The full devolution of all property taxes opens up the possibility of the GLA, or even London LAs, being able to determine the rate, thresholds and exemptions of each. This could cause uncertainty for businesses; without adequate safeguards, it is entirely possible that some local councils would look to “shake down” local businesses to increase their own revenue streams. Moreover, businesses with multiple premises across in England and Wales might face the added complexity of paying different multipliers for different sites.

29. However, on balance, and with the right safeguards and consultation with the business community, **there is no reason for LCCI to oppose the GLA or London LAs being given the power to determine the rate, thresholds and exemptions of the taxes that they retain** for the following reasons:

    A. **<u>The current property taxation system is flawed:</u>** Business rates are unresponsive to fluctuating economic conditions and revaluations are frequently delayed. Council tax valuations are out-of-date and the bands do not reflect the diversity of London’s property market, particularly at the high-value end. The remaining domestic property taxes are recent developments, notoriously distortionary (in the case of Stamp Duty Land Tax) and undermine investor confidence. **There is currently little appetite amongst national policymakers to reform the property tax system; new powers to set rates and thresholds in London would at the very least prompt a debate about their efficacy.**

B. **Taxes will not inevitably rise:** When local government raises its own revenue, it has stronger incentives to encourage local economic growth and create a competitive business environment. Tax changing powers would improve the lines of accountability for the provision of local services in the most cost efficient way. **Econometric studies in Germany and Spain have found that greater levels of fiscal decentralisation improve public sector efficiency, delivering boosts to economic growths and significant savings**[13]. Local decision-makers are likely to have a better understanding of local business circumstances and undertake 'enterprise-zone' style interventions, leading to the lowering of business rates and the regeneration of underdeveloped areas. Moreover, a mechanism could be introduced where LAs were given the determination to set rates only within a set range and only after demonstrable consultation with ratepayers.

C. **It could lead to a more competitive business environment:** Relocating a business from one LA to another is a significant undertaking**;** however, **a recent LCCI survey found that around half of London businesses would consider moving LA if the right environment in another borough existed. Of those, 56% listed "better infrastructure" as a factor and 42% listed "lower business rates" as another (rising to 54% amongst businesses with up to 10 employees)**[14]**.** Given the nature of London's continuous urban area, creating the financial incentive for LAs to attract businesses to their areas, as well as empowering them to determine the rate at which they are charged, could lead to a more competitive business environment in the capital as local authorities compete to offer the best business environment.

D. **It should not be contentious for businesses:** The same LCCI survey revealed that **53% of businesses already (wrongly) believe that LAs are already responsible for setting the level of business rates**[15]**.**

Should borrowing restrictions for local and regional government should be lifted?

30. Key to delivering efficient and cost-effective infrastructure projects is the ability to secure sustainable finance in advance. If the GLA and London LAs were able to retain property taxes and had a stake in creating the conditions to accelerate economic growth, it would make sense to allow them to borrow against future projected growth in the tax receipts from those investments. **To enable this, the fiscal devolution settlement should allow the GLA and London LAs to proceed with tax increment financing projects as long as they remain within the prudential borrowing code.** The size of London's economy (bigger than Sweden) and the unanimous verdict that it will continue to grow economically and demographically long into the future mean that it is able to support such a debt commitment.

31. One of the greatest infrastructure needs for the capital over the coming years is providing enough affordable homes for working Londoners. By allowing the GLA and London LAs to retain property taxes, there will be a certain stream of funding to enable strategic investment to augment London's housing stock. **Further housing finance can be accessed if the artificial limit on what London LAs can borrow from Housing Revenue Accounts are lifted** (as long as they continue to remain within the prudential borrowing code).

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[13] Adam, Delis, Kammas "Fiscal Decentralisation and Public Sector Efficiency" (2008)
[14] LCCI, *Driving Local Growth: The Business Case* (2012)
[15] From April 2012, after the survey took place, councils have had the power to offer business rate discounts.

What will this mean for London's relationship with the rest of the UK?

32. To capture the improvements in governance listed above, **there will need to be a mechanism in place so that the central government grant is not significantly cut after the initial reduction once fiscal devolution has taken place.** If HMT were to reduce the grant in line with increases in yields from devolved property taxes it would undermine the financial incentives for the GLA and London LAs to create a competitive business environment.

33. HMT will still be able to capture the proceeds of growth in London through the growth of income tax, value added tax and corporation tax and redistribute them as it sees fit. As these receipts for the whole of the UK add up to two-thirds of all HMT receipts - compared to all UK property taxes which make up less than 10% - central government will continue to be the main beneficiary of the future economic growth of London[16].

Further Information

34. For further information on this submission, please contact Pier Barrett, Public Affairs Manager (National), on pbarrett@londonchamber.co.uk or 020 7203 1918.

[16] Office of Budgetary Responsibility, "Economic and Fiscal Outlook" (March 2013), Table 4.7 http://cdn.budgetresponsibility.independent.gov.uk/March-2013-EFO-44734674673453.pdf