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Spatial Economics Research Centre

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Business Rate Retention

Nick Clegg's speech on business rate retention suggested that the [reforms will not hurt poor councils](#). This will be true in the short run - because the initial allocations can be made to replicate current funding - but it cannot possibly be true in the long run if retention is to provide incentives to local councils.

Local financing in Britain is incredibly complicated but my understanding of why incentives and level playing fields are incompatible runs roughly as follows. Business rate revenue is currently centralised and then redistributed. HMT will have built assumptions about this stream of revenue in to spending plans. As any growth in business rate revenue now goes to local councils, HMT will either need to cut elements of the central grant or make some items of central expenditure the responsibility of local councils (or both). As this happens, councils who have experienced slow growth in business rates (relative to the average) will be worse off. Countering this would require periodic readjustments to equalise expenditure across local authorities. Even these re-adjustments remove the incentive effect. Only if the reform generates a large amount of additional growth in the country as a whole could top-slicing provide additional money to poorer councils while leaving strong(ish) incentives in place. Even those of us who are optimistic that there would be some impact on growth from providing good incentives would be careful about pushing the argument that far.

A final point - the current plans are about business retention rather than allowing flexibility in business rates. My [research on the impact of business rates](#) when they were set locally suggests the government may be right to be cautious in this area. By comparing employment over time in firms close to local authority borders with that in neighbouring local authorities we showed that business rates have a negative effect on employment growth by existing firms. We also document wide variations in business rates across neighbouring authorities. Perhaps today's local authority leaders would be more worried about the extent to which they could tax business, but the historical record suggests there are reasons to be careful when it comes to re-localising rates.

Posted by [Prof Henry G. Overman](#) on [Thursday, June 30, 2011](#)

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