



Local authorities' power to trade following the  
end of categorisation under Comprehensive  
Performance Assessment  
**Impact Assessment**





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## Summary: Intervention & Options

<b>Department /Agency: Communities and Local Government</b>	<b>Title: Impact Assessment of local authorities' power to trade following the end of categorisation under Comprehensive Performance Assessment</b>	
<b>Stage:</b> Final	<b>Version:</b> 2	<b>Date:</b> 25 August 2009
<b>Related Publications:</b> Explanatory Memorandum to The Local Government (Best Value Authorities) (Power to Trade) (Amendment) (England) 2006 (S.I. No. 3102/2006)		

### Available to view or download at:

[www.opsi.gov.uk/si/em2006/uksiem\\_20063102\\_en.pdf](http://www.opsi.gov.uk/si/em2006/uksiem_20063102_en.pdf)

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### What is the problem under consideration? Why is government intervention necessary?

The power to trade is currently related to performance and is available to local authorities categorised under Comprehensive Performance Assessment (CPA) as "excellent", "good", "fair", "4 star", "3 star", "2 star" and "1 star". Assessment under CPA comes to an end in March 2009. Without action, whilst local authorities currently categorised as being eligible to trade will retain the power, the remaining authorities will not have access to the powers. There will also be uncertainty about how the Government intends to provide long-term access to the power to trade.

### What are the policy objectives and the intended effects?

The intention is to provide local authorities with continued access to the trading powers. This will continue to enable local authorities to act to increase diversity and choice in public service delivery and to trade with the public and private sector where there is a strong business case to do so. Under the preferred option the power would be extended to just 39 authorities, evidence suggests that only a small percentage of these would make any significant use of the power. The combined revenue spending power of the additional 39 local authorities is 1 per cent of the local authority total.

### What policy options have been considered? Please justify any preferred option.

1. Do nothing;
2. Trading powers to higher performers only;
3. Preserve existing authorities' power to trade;
4. Trading powers to all authorities (Preferred Option).

The preferred option provides opportunity for council's to generate revenue to invest in services, reduce council tax and seek collaborative opportunities with the private and voluntary sectors. The revenue spending power of the additional 39 authorities represents just over 1 per cent of local authority market activity and prevents authorities already trading from losing access to revenue streams. This is supported by LGA & Lyons.

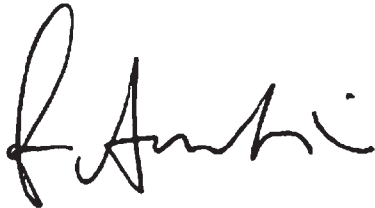
**When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?**

The Department will consider how the impact of the policy can be monitored and evaluated through its research programme. Research is only likely to be carried out in 2010–11 at the earliest.

**Ministerial Sign-off** For consultation stage Impact Assessments:

*I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) the benefits justify the costs.*

Signed by the responsible minister:

A handwritten signature in black ink, appearing to read 'Ian Austin', written in a cursive style.

Ian Austin

**Date:** 2 September 2009

## Summary: Analysis & Evidence

<b>Policy Option: 2</b>		<b>Description: Trading powers to better performers only</b>	
<b>COSTS</b>	<b>ANNUAL COSTS</b>		Description and scale of <b>key monetised costs</b> by 'main affected groups'
	<b>One-off (Transition)</b>	<b>Yrs</b>	
	£	0	
	<b>Average Annual Cost</b> (excluding one-off)		
	£		<b>Total Cost (PV)</b>
<p>Other <b>key non-monetised costs</b> by 'main affected groups'.          Authorities trading may distract resources from core services, although a strong business case should prevent this; some authorities may lose access to the trading powers where they previously had access to them leading to loss of revenue and decreased innovation and collaboration between councils.</p>			
<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>		Description and scale of <b>key monetised benefits</b> by 'main affected groups'
	<b>One-off</b>	<b>Yrs</b>	
	£	0	
	<b>Average Annual Benefit</b> (excluding one-off)		
	£		<b>Total Benefit (PV)</b>
<p>Other <b>key non-monetised benefits</b> by 'main affected groups'.          Improvement in quality of services provided by some councils through enhanced competition; opportunities for councils to make profit from managing their extended freedoms efficiently; better usage of resources for tax payers.</p>			
<p><b>Key Assumptions/Sensitivities/Risks</b> There are inherent risks in undertaking trading activities; however, there are safeguards in place to ensure that trading is undertaken with an appropriate level of consideration by an authority. Local authorities may only trade in function related activities and must prepare and approve a business case before trading.</p>			
<b>Price Base</b> <b>Year</b>	<b>Time Period</b> <b>Years</b>	<b>Net Benefit Range</b> (NPV) £	<b>NET BENEFIT</b> (NPV Best estimate) £

What is the geographic coverage of the policy/option?		England			
On what date will the policy be implemented?		Autumn 2009			
Which organisation(s) will enforce the policy?		n/a			
What is the total annual cost of enforcement for these organisations?		£			
Does enforcement comply with Hampton principles?		Yes			
Will implementation go beyond minimum EU requirements?		No			
What is the value of the proposed offsetting measure per year?		£			
What is the value of changes in greenhouse gas emissions?		£			
Will the proposal have a significant impact on competition?		No			
Annual cost (£-£) per organisation (excluding one-off)		Micro	Small	Medium	Large
Are any of these organisations exempt?		Yes/No	Yes/No	N/A	N/A
<b>Impact on Admin Burdens Baseline</b> (2005 Prices)		(Increase – Decrease)			
Increase of £	Decrease of £	<b>Net Impact £</b>			
Key:	<b>Annual costs and benefits: Constant Prices</b>	<b>(Net) Present Value</b>			



## Summary: Analysis & Evidence

<b>Policy Option: 3</b>		<b>Description: Preserve existing authorities power to trade</b>	
<b>COSTS</b>	<b>ANNUAL COSTS</b>		Description and scale of <b>key monetised costs</b> by 'main affected groups' The proposal does not place any additional costs on local authorities.
	<b>One-off (Transition)</b>	<b>Yrs</b>	
	£0	0	
	<b>Average Annual Cost (excluding one-off)</b>		
	£0	<b>Total Cost (PV)</b> £0	
Other <b>key non-monetised costs</b> by 'main affected groups'. Improving authorities without access to the trading powers would result in less scope for collaborative working with the private and voluntary sectors and authorities would not be able to realise the financial benefits of trading for a profit.			
<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>		Description and scale of <b>key monetised benefits</b> by 'main affected groups'
	<b>One-off</b>	<b>Yrs</b>	
	£0	0	
	<b>Average Annual Benefit (excluding one-off)</b>		
	£0	<b>Total Benefit (PV)</b> £0	
Other <b>key non-monetised benefits</b> by 'main affected groups'. Improvement in quality of services provided by some councils through enhanced competition; opportunities for some councils to make profit from managing their extended freedoms efficiently and better usage of resources for taxpayers. Less authorities would be subject to the risks of undertaking trading activities.			
<b>Key Assumptions/Sensitivities/Risks</b> There are inherent risks in undertaking trading activities; however, there are safeguards in place to ensure that trading is undertaken with an appropriate level of consideration by an authority. Local authorities may only trade in function related activities and must prepare and approve a business case before trading.			
<b>Price Base Year</b>	<b>Time Period Years</b>	<b>Net Benefit Range (NPV)</b> £	<b>NET BENEFIT (NPV Best estimate)</b> £

What is the geographic coverage of the policy/option?		England			
On what date will the policy be implemented?		Autumn 2009			
Which organisation(s) will enforce the policy?		n/a			
What is the total annual cost of enforcement for these organisations?		£			
Does enforcement comply with Hampton principles?		Yes			
Will implementation go beyond minimum EU requirements?		No			
What is the value of the proposed offsetting measure per year?		£0			
What is the value of changes in greenhouse gas emissions?		£0			
Will the proposal have a significant impact on competition?		No			
Annual cost (£-£) per organisation (excluding one-off)		Micro	Small	Medium	Large
Are any of these organisations exempt?		Yes/No	Yes/No	N/A	N/A
<b>Impact on Admin Burdens Baseline</b> (2005 Prices)		(Increase – Decrease)			
Increase of £	Decrease of £0	<b>Net Impact £</b>			
Key:	<b>Annual costs and benefits: Constant Prices</b>	<b>(Net) Present Value</b>			

## Summary: Analysis & Evidence

Policy Option: 4

Description: Trading powers to all authorities  
(Preferred Option)

<b>COSTS</b>	<b>ANNUAL COSTS</b>		<p>Description and scale of <b>key monetised costs</b> by 'main affected groups'</p> <p>There would be some costs in setting up a trading company and running costs for the operation, depending on the service being provided. The required business case should demonstrate how a commercial return is to be achieved and start-up costs should be scoped in that consideration.</p>
	<b>One-off (Transition)</b>	<b>Yrs</b>	
	£50,000	1	
	<b>Average Annual Cost</b> (excluding one-off)		
	£8 million		<b>Total Cost (PV) £67 million</b>
<p>Other <b>key non-monetised costs</b> by 'main affected groups'.</p> <p>Authorities trading may distract resources from core services, although a strong business case should prevent this, larger number of authorities subject to the risks inherent in undertaking trading activities (such as financial loss). There is also the possibility that private businesses operating in the same market may be affected by the competition offered by local authority trading companies.</p>			

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>		<p>Description and scale of <b>key monetised benefits</b> by 'main affected groups'</p> <p>The benefits for a local authority company is the turnover as part of the business.</p>
	<b>One-off</b>	<b>Yrs</b>	
	£0		
	<b>Average Annual Benefit</b> (excluding one-off)		
	£8.6 million		<b>Total Benefit (PV) £72 million</b>
<p>Other <b>key non-monetised benefits</b> by 'main affected groups'.</p> <p>Improvement in quality of services through enhanced competition, opportunity to generate revenue, and to seek collaborative and partnering opportunities with SMEs and the wider private and voluntary sectors. Revenue generated would enable authorities either to invest in public services or keep down Council Tax.</p>			

**Key Assumptions/Sensitivities/Risks** There are inherent risks in undertaking trading activities; however, there are safeguards in place to ensure that trading is undertaken with an appropriate level of consideration by an authority. Local authorities may only trade in function related activities and must prepare and approve a business case before trading.

<b>Price Base Year</b> 2008	<b>Time Period Years</b> 10	<b>Net Benefit Range (NPV)</b> <b>£0–10 million</b>	<b>NET BENEFIT (NPV Best estimate)</b> <b>£5 million</b>			
What is the geographic coverage of the policy/option?			England			
On what date will the policy be implemented?			Autumn 2009			
Which organisation(s) will enforce the policy?			n/a			
What is the total annual cost of enforcement for these organisations?			£			
Does enforcement comply with Hampton principles?			Yes			
Will implementation go beyond minimum EU requirements?			N/A			
What is the value of the proposed offsetting measure per year?			£			
What is the value of changes in greenhouse gas emissions?			£			
Will the proposal have a significant impact on competition?			No			
Annual cost (£-£) per organisation (excluding one-off)		Micro	Small	Medium	Large	
Are any of these organisations exempt?		Yes/No	Yes/No	N/A	N/A	
<b>Impact on Admin Burdens Baseline</b> (2005 Prices)			(Increase – Decrease)			
Increase of £		Decrease of £		<b>Net Impact £</b>		
Key:	<b>Annual costs and benefits: Constant Prices</b>		<b>(Net) Present Value</b>			

## Evidence Base (for summary sheets)

### Trading powers

1. The *Local Authorities (Goods and Services) Act 1970*<sup>1</sup> governs the way in which local authorities are allowed to 'trade' with other public bodies. It authorises local authorities to enter into agreements with public bodies for the provision of goods, materials, and administrative, professional and technical services, for the use of vehicles, plant and apparatus, and for the carrying out of maintenance. There is also a power for the Secretary of State to designate by order that any person(s) exercising functions of a public nature shall be a public body for the purposes of the Act.
2. The Local Government White Paper *Strong Local Leadership – Quality Public Services* (2001)<sup>2</sup> announced a new Comprehensive Performance Assessment (CPA) framework to assess local authorities' delivery of national and local priorities. The White Paper promised that the highest performing local authorities would be given greater freedom and flexibilities.
3. Section 95 of the *Local Government Act 2003* ("the 2003 Act")<sup>3</sup> authorises the Secretary of State, by order, to permit Best Value authorities to do for a commercial purpose anything which they are authorised to do for the purpose of carrying on any of their ordinary functions. This is commonly known as the power to trade. The power to trade is only able to be exercised through a local authority company (within the meaning of Part 5 of the *Local Government and Housing Act 1989*<sup>4</sup>). Trading under the power needs to be directed towards the achievement of Best Value in the related function. This means that local authorities cannot set up trading arms unrelated to core services or functions.
4. The power may not be used to authorise Best Value authorities to trade in a statutory service which they are already obliged to provide with a person to whom they are already obliged to provide it, or to use the new powers where there are existing trading powers.

<sup>1</sup> [www.opsi.gov.uk/acts/acts1970/pdf/ukpga\\_19700039\\_en.pdf](http://www.opsi.gov.uk/acts/acts1970/pdf/ukpga_19700039_en.pdf)

<sup>2</sup> [www.communities.gov.uk/documents/localgovernment/pdf/143810.pdf](http://www.communities.gov.uk/documents/localgovernment/pdf/143810.pdf)

<sup>3</sup> [www.opsi.gov.uk/acts/acts2003/ukpga\\_20030026\\_en\\_1](http://www.opsi.gov.uk/acts/acts2003/ukpga_20030026_en_1)

<sup>4</sup> [www.opsi.gov.uk/acts/acts1989/Ukpga\\_19890042\\_en\\_1](http://www.opsi.gov.uk/acts/acts1989/Ukpga_19890042_en_1)

## Trading Order

5. The *Local Government (Best Value Authorities) (Power to Trade)(England) Order 2004* ("the 2004 Order")<sup>5</sup> provides the power to trade to those local authorities who have been categorised, by order under section 99 of the 2003 Act, as having attained a certain level of performance namely those authorities who have been categorised by order under as "excellent", "good" or "fair".

## CPA Framework

6. The Audit Commission independently carry out assessments, which placed councils into one of five categories – excellent, good, fair, weak and poor. The Government's stated policy was that those authorities categorised as excellent, good and fair would have access to greater powers to trade. In December 2005 the Audit Commission published a revised CPA framework, *The Harder Test* ("CPA 2005")<sup>6</sup>, for England's 150 single tier and county councils. Under CPA *The Harder Test* framework, councils receive an overall performance category ranging from 0 to 4 stars, with 4 stars being the highest. District CPA has not been altered to incorporate *The Harder Test* framework and District councils (which are not single tier councils) are not brought within that that framework.
7. In January 2006, the then *Office of the Deputy Prime Minister* (ODPM) launched a consultation exercise seeking views on the handling of freedoms and flexibilities under CPA 2005, *Freedoms and Flexibilities*<sup>7</sup>. The Government's preferred option was to extend freedoms and flexibilities downwards across star categories. This would mean that the trading powers, currently available to excellent, good and fair authorities, would be given to 4 stars, 3 stars, 2 stars and 1 star authorities. Changes were not proposed for the freedoms and flexibilities of those District Councils (which are not single tier councils), and they retain the current categorisation labels of excellent to poor.
8. Following consultation, the *Local Government (Best Value Authorities) (Power to Trade) (Amendment) (England) Order 2006* ("the 2006 Order")<sup>8</sup> amended the 2004 Order by applying the power to trade to those local authorities categorised in an order under section 99 of the 2003 Act as "4 stars", "3 stars", "2 stars" and "1 star" as well as to those authorities categorised as "excellent", "good" or "fair".

<sup>5</sup> [www.opsi.gov.uk/si/si2004/20041705.htm](http://www.opsi.gov.uk/si/si2004/20041705.htm)

<sup>6</sup> [www.audit-commission.gov.uk/localgov/audit/cpa/CPA\\_STCC/cpaarchive/Pages/cpaframework2005.aspx](http://www.audit-commission.gov.uk/localgov/audit/cpa/CPA_STCC/cpaarchive/Pages/cpaframework2005.aspx)

<sup>7</sup> [www.communities.gov.uk/documents/localgovernment/pdf/143663.pdf](http://www.communities.gov.uk/documents/localgovernment/pdf/143663.pdf)

<sup>8</sup> [www.opsi.gov.uk/si/si2006/20063102.htm](http://www.opsi.gov.uk/si/si2006/20063102.htm)

## Current proposal

9. It was proposed in a *Freedoms & Flexibilities Consultation*<sup>9</sup> to extend the power to trade commercially to all local authorities. The responses to the consultation on how to handle the trading powers under CPA 2005 received support from the LGA and a number of respondents to extend the power further to all authorities. The *Lyons Inquiry into Local Government*<sup>10</sup> also recommended that the power should be extended to all local authorities.
10. The terms of a new Trading Order will continue to place safeguards on the use of the power, for example, by requiring an authority to prepare and approve a business case before trading. This requirement ensures that authorities manage risks effectively. However, local authorities will need to continue to base firmly any proposed trading activity on the need to secure value for money for the taxpayer and to have regard to relevant good practice.
11. The recommended option provides an incentive for improvement. The benefits of the preferred option include improvement in quality of services provided by councils through enhanced competition. There would be opportunity for more councils to make profit from having access to trading powers and more councils able to seek collaborative opportunities with other sectors from having access to trading powers.

## Previous RIAs

12. Full Regulatory Impact Assessments were produced for the *Local Government Bill 2003 and for the Local Government (Power to Trade) (England) Order 2004* and the *Local Government (Best Value Authorities) (Power to Trade) (Amendment) (England) Order 2006*.

## 2009 Consultation

13. On 6 May 2009, the Department published the consultation document, *Proposed changes to the delivery of Local Authorities' and Fire & Rescue Authorities' Freedoms and Flexibilities after the introduction of Comprehensive Area Assessment*<sup>11</sup>. Amongst other things, the consultation asked:
  - Question 3: Do you agree that the power to trade should be extended to all local authorities?

<sup>9</sup> [www.communities.gov.uk/documents/localgovernment/pdf/1222822.pdf](http://www.communities.gov.uk/documents/localgovernment/pdf/1222822.pdf)

<sup>10</sup> [www.lyonsinquiry.org.uk/](http://www.lyonsinquiry.org.uk/)

<sup>11</sup> [www.communities.gov.uk/publications/localgovernment/freedomsflexibilitiescaa](http://www.communities.gov.uk/publications/localgovernment/freedomsflexibilitiescaa)

14. Thirty-seven responses were received to the consultation with contributions from local authorities, fire & rescue authorities, private sector (including SMEs) and a charity. Not all respondents answered the specific questions in relation to local authority trading, however where there were general comments relating to local authority trading, these were also considered.
15. Twenty-one respondents (57%) supported the recommended option to extend the powers to trade to all local authorities, one respondent (3%) did not support this and 15 respondents (40%) did not answer this question.
16. Reasons for support include:
  - that it would enable the generation of income streams
  - absence could stifle innovation and prevent collaboration with partners
  - it should improve competition in the delivery of public services
  - it should encourage greater consistency and help diminish the 'postcode-lottery' of services that currently exists.
17. The respondent who did not support the proposal considered that some local authority companies would have a captive market, that they use their local authority status to win business, and that they can leverage a competitive advantage over private providers.
18. The majority of responses to the consultation paper supported the extension of the power to trade to all local authorities. This approach will ensure that local authorities continue to have available the necessary power to improve services for their communities, provide enhanced competition in the public services market, and to generate revenue to keep down council tax or invest in public services. With regard to the respondent who did not support the proposal, there are appropriate legal safeguards in place to protect from such abuses of the system. The 2004 Order requires an authority to recover the costs of any services provided to the company. In addition, local authorities are required to comply with competition law, state aid principles, as well as the procurement regulations which enforce rules on transparency, free movement of goods and non discrimination.

## Local authority coverage

19. The Government's approach to providing local authorities with access to the trading powers has been through its Freedoms and Flexibilities programme linked to CPA categorisation. This means that only those higher performing local authorities have had access to the power to trade. Subsequent trading orders have extended access to the trading powers to more CPA categories following CPA *The Harder Test*. Under



the most recent Categorisation Order, the 349 higher performing local authorities have access to the trading powers, with 39 authorities currently restricted in their access to the trading powers. Whilst this means that 10 per cent of local authorities do not have access to the trading powers, this figure is not necessarily representative when you look at the 'economic activity' of the authorities which do not have access to the powers. Using the 2007–08 CLG Revenue Outturn data<sup>12</sup>, the revenue spend of the authorities which do not have access to trading powers amounts to just over 1 per cent of the total local authority revenue spend.

## Sectors and groups affected

20. The trading powers are enabling powers. It is expected that local authorities will seek to engage in trading activities only where the authority already has a strong track record of delivery in that service area. The proposal to extend the trading power potentially affects a range of sectors, groups and markets. It is anticipated that the proposal would have a positive competitive effect on the private sector due to local authorities engaging in new activities and stimulating markets and increasing competition. The powers allow local authorities to engage in activities which are also undertaken by the private sector; however, it is not necessary to assume that local authorities will necessarily be displacing business from the private sector. Trading activity could also create sub-contracting and partnering opportunities with local authorities. The trading powers can be expected also to be used to improve competition and contestability or to fill a gap in the market in the provision of services to the public.

## Research on use of trading powers

21. ODPM (now CLG) commissioned a baseline evaluation of the use, awareness, and emerging impact of freedoms and flexibilities in local government. The report was published as *Evaluation of Freedoms and Flexibilities in Local Government: Baseline Study* (CLG, September 2006)<sup>13</sup>. In view of the relatively small size of the samples, caution should be used in drawing inferences about English local authorities as a whole. The report found that:
- between 20 and 30 per cent of respondents reported that their authorities were taking up trading and charging powers
  - 3 per cent of authorities saying they had made significant use of the power
  - 18 per cent of authorities said they had made some use of it
  - 56 per cent said they had made no use at all of the power

<sup>12</sup> [www.communities.gov.uk/publications/corporate/statistics/revenue200708provouturn](http://www.communities.gov.uk/publications/corporate/statistics/revenue200708provouturn)

<sup>13</sup> [www.communities.gov.uk/publications/localgovernment/evaluationfreedoms2](http://www.communities.gov.uk/publications/localgovernment/evaluationfreedoms2)

- this low level of use does not seem to be caused by a low level of awareness of the powers now available.
22. Research by the Local Government Association (LGA) in November 2004, *Loosening the Reins*<sup>14</sup>, found:
- low level of use of the power with only 2 per cent of councils using their new powers to trade
  - a further 18 per cent intending to use the powers
  - 64 per cent of authorities using, or planning to use, the power identified raising revenue as a key objective.
23. Research undertaken by INLOGOV (the Institute of Local Government Studies) for CLG in November 2007, *Local Authority Trading: Research Report*<sup>15</sup>, also found little evidence of authorities using or planning to use their increased power to trade, though upper tier authorities were more likely than districts to indicate a plan for marginal increases in trading activity. The Report found:
- 72 per cent of local authorities surveyed trade, with an annual average income of £3m (this figure includes trading under other powers)
  - 29 per cent of authorities trade in 2003 Act powers
  - overall, 25 per cent of local authorities aim to make surplus
  - local authorities which did not trade cited the following as the main barriers to trading:
    - cultural barriers
    - non-trading authorities were more likely to perceive European regulations as restricting local authority trading than trading authorities.

## Known take up of the powers

24. Whilst the research undertaken by INLOGOV suggests that 29 per cent of local authorities trade in 2003 Act powers, we have been unable to establish more than three or four authorities actively trading in the market. Each of those authorities has on average two companies commercially trading.

<sup>14</sup> [www.wlga.gov.uk/download.php?id=144&l=1](http://www.wlga.gov.uk/download.php?id=144&l=1)

<sup>15</sup> [www.communities.gov.uk/publications/localgovernment/tradingresearchreport](http://www.communities.gov.uk/publications/localgovernment/tradingresearchreport)

## Services traded in

25. According to the INLOGOV research cited above, the most commonly traded local authority services are:
- grounds maintenance
  - building cleaning/maintenance
  - highways maintenance
  - vehicle maintenance.
26. This list should be considered with some caution as the trading research looked at all powers under which local authorities trade and these typically follow the traditional DSO/DLO (Direct Service/Direct Labour Organisation) which local authorities ran in the past. However, it is likely that where a local authority has a successful DSO/DLO, then that may be incorporated as a trading company. The services which we established know local authorities are trading in under the 2003 Act powers, and which form the basis of the cost-benefit analysis above are in the area of:
- Facilities management and small building works
  - Temporary staff
  - Transport services (in particular those which would otherwise require subsidy such as rural, evening and Sunday services)
  - Property consultancy services
  - Waste management and recycling
  - School and venue catering
  - Grounds and highways maintenance
  - Environmental services.

## Costs and benefits of setting up and operating a trading company

27. At the time of preparing the Impact Assessment, four local authority trading companies were known to the Department. All four were contacted in order to obtain relevant values to be used in estimating the costs and benefits arising from the creation of additional trading businesses. Key questions put to existing trading companies included turnover, gross profit, type of activity and start-up costs. The evidence gained in this exercise was used to inform the assumptions and calculations presented in the text box '**range of scenarios under option 4**' shown later in this document.

## Risk in the context of trading

28. Section 3 of the *Local Government Act 1999*<sup>16</sup> places a duty of Best Value on local authorities and other public bodies. This requires them to secure continuous improvement in the way in which they exercise their functions, having regard to a combination of economy, efficiency and effectiveness. Trading under the 2003 Act powers needs to contribute towards Best Value in the related function.
29. The trading power permits local authorities to act in an entrepreneurial manner and engage in commercial activities. There are inherent risks in undertaking such activities especially when taxpayer's money is being used to fund these ventures. However, there are safeguards in place to ensure that trading is undertaken with an appropriate level of consideration by a local authority. The trading power permits local authorities to trade in function related activities only (i.e. authorities need to have the power to engage in an activity before they can trade in it). This should minimise the risk as a local authority should not be engaging in activities in which they do not have any experience or expertise of undertaking. A local authority must also prepare and approve, as appropriate within its governance arrangements, a business case before exercising the 2003 Act trading powers. This provides further safeguards for taxpayers' money by ensuring that there is a rationale and full consideration presented through the appropriate local authority executive arrangement before undertaking trading activities. In addition, a local authority must make arrangements to ensure that taxpayer's money is spent appropriately. This duty has generally emerged from case law *cf Roberts v. Hopwood* [1925] AC 578 and in *Bromley London Borough Council v Greater London Council* [1983] 1 AC 768. The fiduciary duty will apply to a local authority seeking to trade.

## Options analysis

### Option 1: 'Do nothing'

30. Whilst the categorisation order remains in force, local authorities which are currently categorised as under that order as eligible to trade will continue to have access to the trading powers.

### **RISKS**

31. Diversity and choice in the delivery of public services would be restricted. Local authorities would be prevented from extending and improving the range of services they offer. The introduction of new players into the market would be restricted and Government policy in this area would be put into reverse.

<sup>16</sup> [www.opsi.gov.uk/acts/acts1999/ukpga\\_19990027\\_en\\_1](http://www.opsi.gov.uk/acts/acts1999/ukpga_19990027_en_1)

32. Given that CPA will be formally coming to an end once Comprehensive Area Assessment reports later this year, the do nothing approach will create further uncertainty in local government about how Government intends to provide access to the power to trade. Continued linkage to categories which are no longer relevant is not a sustainable solution.

### **COSTS**

33. Authorities that have begun to trade successfully would now have uncertainty in whether the power to trade will continue and may start winding up their current trading activities. This could:
- place a greater burden on taxpayers where the company is trading at a profit and paying dividends to the local authority
  - mean that there would be less competition and diversity of services which could negatively impact on consumers and other businesses which current receive services from the company.
34. There would be less scope for collaborative working with the private and voluntary sectors.

### **BENEFITS**

35. Any uncertainty created by not clarifying how the trading powers will be taken forward and therefore winding down their trading activity, would mean that the local authorities would no longer be subject to the inherent risks of undertaking trading activities (such as financial loss).

### **Option 2: 'Grant trading powers to better performers only'**

36. The successor assessment regime to CPA is CAA. However, there is no direct correlation between the CPA and CAA framework and CAA is an assessment of the area, and not of the individual council's performance. There is also no legislation to enable CAA to provide freedoms to local authorities. Therefore, this option is rejected.

### **Option 3: Preserve existing authorities power to trade**

37. As with Option 1, this means that to some degree, diversity and choice in the delivery of public services would be restricted but there would be certainty about how the Government intended to provide access to the trading powers. As there would be greater certainty around the trading powers than under Option 1, it is likely that more local authorities would undertake trading activities. This means that there could be a greater number of trading companies.

### ***COSTS***

38. This could prevent authorities with improving performance from accessing the trading powers and would not help stimulate innovation and collaboration between councils.
39. As there would be greater certainty around the trading powers than under Option 1, those authorities with the preserved power to trade would be more likely to undertake trading. This means that authorities would be subject to the risks of undertaking trading activities (such as financial loss).
40. Authorities without access to the trading powers would not have scope for collaborative working with the private and voluntary sectors.
41. Greater potential competition for private sector suppliers which could lead to local authority companies taking a greater share of the market.

### ***BENEFITS***

42. As there would be greater certainty around the trading powers than under Option 1, it is likely that more local authorities would undertake trading activities. This means that there could be a greater number of trading companies which could lead to:
  - improvements in quality of services provided by some councils
  - greater competition and diversity in the delivery of services which would have a positive effect on consumers and businesses in receipt of services from the company
  - increased income streams, potentially leading to a reduction in council tax burdens.

## **Option 4: Grant trading powers to all authorities (Preferred Option)**

### ***RISKS***

43. When trading in their ordinary functions, authorities may be tempted to enter into areas of activity for which they are not best qualified and do not have the appropriate level of expertise rather than concentrating on improving delivery of their core functions. Whilst extending access to the trading powers to the 39 authorities is not without risk, there are safeguards in place to ensure that trading is undertaken with an appropriate level of consideration by a local authority (see paragraph 29 above).

### ***COSTS***

44. This option will provide greater opportunities for more trading companies. Resulting in:
  - start up and running costs for authorities choosing to trade
  - potential for local authorities to distract resources away from core public services, although a strong business case should seek to prevent this

- larger number of authorities subject to the risks inherent in undertaking trading activities (such as financial loss)
- greater potential competition for private sector suppliers which could lead to local authority companies taking a greater share of the market.

### **BENEFITS**

45. This option provides the greatest scope for opportunities under the trading powers as it is providing them to all local authorities. This means that it is more likely that as there will be more local authorities with the trading powers, it provides the greatest opportunity for the most trading companies. This could lead to:

- greater competition and diversity in the delivery of services which would have a positive effect on consumers and businesses in receipt of services from the company
- increased income streams, potentially leading to a reduction in council tax burdens
- maximum scope for collaborative working with the private and voluntary sectors
- improvement in quality of services provided by councils, through enhanced competition
- more councils able to seek collaborative opportunities with other sectors from having access to trading powers.

## Monetised costs and benefits

46. The proposal will extend the power to trade under the 2003 Act to a further 39 authorities. We know from research that 29 per cent of authorities use the 2003 trading powers but that only 3 per cent make significant use of the powers. This would suggest that 11 authorities might avail themselves of the powers and between one and two authorities would make any significant use of the power. Thirty-eight out of the 39 authorities that the power would be extended to are small, lower-tier authorities and it would seem unusual for these authorities to make significant use of these powers.

47. Whilst we do not know how many services an authority would choose to trade in, the research suggest a cautious approach and it seems unlikely that any of these authorities would trade in more than one or two functions, at least initially. There would be minimal costs in setting up a trading company and start-up costs for the operation (for example, preparing a business case is unlikely to exceed £10,000). However the business case for an operation under the 2003 powers should demonstrate how a commercial return is to be achieved and set-up costs and start-up costs should be scoped in that document. The assumptions and calculations informing the Summary Analysis and Evidence are outlined in the textbox below.

## Range of scenarios under Option 4

Potential uptake due to the extra 39 authorities having access to the trading powers

### Assumptions

The application of the power is discretionary and therefore there could be no trading company established as a result of the statutory change. However, given that four businesses are known to exist:

- It is assumed that **one additional trading company** is established as a result of the extension of the powers to the 39 local authorities currently excluded from the trading provisions.
- However, the number of additional local authority as a result of the statutory change is most likely to vary between zero and a maximum of two. These values are used in calculating the range of Present Values shown in the summary table above.
- The average turnover of a 'mature' local authority trading business is approximately £13.5m (based on average turnover of three example local authority companies – the fourth business with over £100m in turnover is treated as an outlier).
- The gross profit margin is approximately 8 per cent (based on average gross profit of the three example local authority companies). The average operating cost of the additional trading business is obtained by subtracting the profit margin from the average estimated turnover. (Thus the operating cost of the mature business is calculated to be approximately £12.5m).
- Any new business created as a result of the change in the legislation results in a start-up trading business with a total initial turnover of £5m (and operating cost of £4.6m). Over a 10 year period this increases to the estimated £13.5m turnover of a 'mature' business (implying an annual average compound growth rate of approximately 12 per cent).
- Based on evidence drawn from existing trading companies, the initial start-up cost is put at £50,000.

### Average Annual Totals and Present Values

Using the assumptions described above, it is calculated that:

- The mean annual turnover of one additional trading business is £8.6m over a 10 year period.
- The mean annual operating cost of one additional trading business is £8m over a 10 year period. (Based on the calculation that cost is equal to the difference between total revenue and the gross profit margin of 8 per cent).
- The mean gross profit over the 10 year period is £0.6m.
- The present value of the estimated cost of operating an additional trading business is £67m over the 10 year period. (i.e. using the base year estimate of £4.6m which grows to £12.5m in the final year).
- The present value of the estimated revenue achieved through operating an additional trading business is £72m over the 10 year period. (i.e. using the base year estimate of £5m which grows to £13.5m in the final year).
- The net present value of one additional trading company is £5m, however, given the assumption above that the expected outcome is likely to lie between zero and two businesses created as a result of the statutory change, the net present value could vary between 0 and £10m.
- A discount value of 3.5 per cent was used in the present value analysis.



## Recommended option

48. **Option 4** is the recommended option. It provides the greatest flexibility while minimising the risks involved. The benefits of the preferred option include: improvement in quality of services through enhanced competition. There would be opportunity for more councils to generate revenue from having access to trading powers and more councils able to seek collaborative and partnering opportunities with SMEs and the wider private and voluntary sectors by having access to trading powers. Revenue generated would enable local authorities either to invest in public services or used to keep down council tax.
49. Evidence would suggest that of the 39 authorities that the power would be extended to, only a small percentage of those authorities would actually make any significant use of the power. The combined revenue spending power of the additional 39 local authorities is just over 1 per cent of the total local authority revenue spend for 2007–08 and therefore represents a very minor potential increase in local authority market activity. The preferred option would prevent those authorities already undertaking trading activities from having to wind down those activities and losing access to revenue generated through trading. The LGA have pressed and the Lyons Inquiry recommended that trading powers should be extended to all authorities to remove any uncertainty about continued access.

## Small Firms' Impact Test

50. Whilst the trading powers mean that authorities are potentially trading in competition with the private sector, various safeguards have been built in. Safeguards include requiring authorities to adopt a genuinely risk-based approach, based on a sound business case prepared for the proposed trading activity. The arrangements secure that authorities are not able to distort markets through the provision of inappropriate subsidies to trading companies. In order to maintain a level playing field with local businesses, the new powers to trade will be subject to a requirement that it must take place through a corporate body formed by the authority. This means that surpluses on commercial operations under the new power will be subject to taxation in the same way as for other companies. Local authorities like other bodies are subject to and must abide by competition law and State Aid principles.

51. The statutory guidance on local authority trading, *General power for local authorities to trade in function related activities through a company*<sup>17</sup>, is clear that authorities should consider the requirements of competition law for any proposed charging and trading activities. The INLOGOV survey data suggests that 27 per cent of trading authorities voluntarily undertook such assessments for trading preceding the 2003 Act. Case study evidence suggests that the impact of local authority trading on the business community can have positive effects. Some benefits identified were local opportunities for sub-contracting, and the delivery of back-office and transactional services to local community and not-for-profit sectors.

## Competition Assessment

52. A full Competition Assessment carried for the Regulatory Impact Assessment published to coincide with the introduction of the *Local Government Bill 2003*.
53. The underlying assumptions in the analysis have not changed since then. The trading powers were made available to local authorities in 2004 and the new Order merely makes some changes to the authorities covered following alterations to the CPA regime.
54. In summary the conclusions of the Competition Assessment were:
- the new powers could lead to increased contestability and/or increased competition in markets (especially those which are currently inefficient or less active)
  - greater levels of trading by local authorities could lead to efficiency gains through increased economies of scale, and so could benefit consumers through lower prices, better quality, or both
  - there could however be a number of adverse effects arising from certain advantages that local authorities may possess, with consequent potential for the abuse of market power
    - conflicts of interest may arise for local authorities in cases where they both regulate markets and participate in them (for example where withholding planning consents would create barriers to entry)
    - the legislation could potentially facilitate collusion between local authorities, thereby adversely affecting private sector businesses, either through increased information asymmetry or affecting bidding outcomes
    - in terms of existing markets, local authorities may be able to exploit the benefits of an existing customer base and crowd out the private sector

<sup>17</sup> [www.communities.gov.uk/publications/localgovernment/generalpower](http://www.communities.gov.uk/publications/localgovernment/generalpower)

- the legislation may alter the competitive process through increased consolidation and the possible exclusion of small businesses from particular markets.

55. In relation to the bullet points above, it should be noted that:
- the power to trade will only be exercisable through a company structure, which will be subject to regulation in the same way as other commercial bodies (e.g. taxation). This will help ensure a level playing field with the private sector
  - local authorities, like other bodies, are subject to and must abide by competition legislation. Trading by local authorities may be subject to the provisions in the Competition Act 1998 and/or Articles 81 and 82 of the EC Treaty (see paragraph 9.5).
56. The *Competition Act 1998*<sup>18</sup> introduced two prohibitions which reflect Articles 81 and 82 of the EC Treaty respectively. The Chapter I prohibition covers agreements between undertakings that have the object or effect of distorting competition in the United Kingdom, or a part of the United Kingdom. The Chapter II prohibition makes unlawful conduct by one or more undertakings which may amount to an abuse of a dominant position in a market in the United Kingdom.
57. Authorities should consider any proposed trading activities very carefully against the requirements of competition law, consulting their own lawyers as necessary. Trading by local authorities may be subject to the provisions in the *Competition Act 1998* and/or Articles 81 and 82 of the EC Treaty.
58. Whether or not a local authority may be considered an undertaking with respect to a particular activity (and therefore subject to competition rules), depends on whether the activity is 'an economic activity'. The new provisions do not make a significant difference in a local authorities' obligation to abide by competition rules.
59. In addition to the general consultation exercise for the 2003 Act, discussions were held with the Small Business Service and the Office of Fair Trading, CBI and other representative bodies for small businesses. The then ODPM also received and responded to written representations from the Federation of Small Businesses on their concerns with the charging and trading provisions in the Bill.

<sup>18</sup> [www.opsi.gov.uk/acts/acts1998/ukpga\\_19980041\\_en\\_1](http://www.opsi.gov.uk/acts/acts1998/ukpga_19980041_en_1)

## Impact Assessments

### Equality assessment

60. The trading power is a non-prescriptive enabling power and should not in itself have an adverse impact on equalities. When making use of the trading powers, as part of their legal duty, local authorities should consider whether there are any equality considerations that need to be addressed.

### Health impact assessment

61. The trading power is a non-prescriptive enabling power and should not in itself have an adverse impact on health issues. When making use of the trading powers local authorities should consider whether there are any adverse health impact considerations that need to be addressed.

### Rural considerations

62. The trading power is a non-prescriptive enabling power and should not in itself have an adverse impact on rural issues. When making use of the trading powers local authorities should consider whether there are any adverse rural considerations that need to be addressed.

### New Burdens Assessment

63. These are enabling powers and authorities are not obliged to use them. The trading power does not increase the cost of providing local authority services. Successful trading operations can be expected to generate revenue which can be used for further investment in services or for keeping council tax down.

## Monitoring and evaluation

64. The Department will consider how the impact of the revised policy can be monitored and evaluated through its programme of local government research. Given the need to allow some time for the revised policy to take effect, such research is only likely to be carried out in the 2010–11 or later programmes.

## Summary and recommendations

- 65. *The recommendation is to extend the power to trade to all local authorities*** (Option 4 in this Impact Assessment), which the majority of responses to the consultation paper supported. This option provides the greatest flexibility while minimising the risks involved. The benefits include: improvement in quality of services provided by councils through enhanced competition, greater opportunity for more councils to generate revenue from having access to trading powers, and more councils able to seek collaborative and partnering opportunities with SMEs and the wider private and voluntary sectors. Revenue generated will enable local authorities either to invest in public services or used to keep down council tax.

66. Evidence would suggest that of the 39 authorities that the power would be extended to, only a small percentage of those authorities would actually make any significant use of the power. The combined revenue spending power of the additional 39 local authorities is just over 1 per cent of the total local authority revenue spend for 2007-08 and therefore represents a very minor potential increase in local authority market activity. The recommended option would prevent those authorities already undertaking trading activities from having to wind down those activities and losing access to revenue generated through trading. The proposal is supported by the local government sector.

## Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

**Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.**

Type of testing undertaken	Results in Evidence Base?	Results annexed?
Competition Assessment	Yes	Yes
Small Firms Impact Test	Yes	Yes
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	Yes	Yes
Race Equality	Yes	Yes
Disability Equality	No	No
Gender Equality	No	No
Human Rights	Yes	Yes
Rural Proofing	Yes	Yes

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